

# **The Boundary-Line Function of the Economic loss Rule**

Vincent R. Johnson\*

Draft Oct 3, 2008

Boundary-Line Function.Final Rev.3.wpd

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## **I. The Rise of the Economic Loss Rule**

Tort scholars and jurists have recently focused on what is often called “the economic loss rule” in an effort to resolve its uncertainties.<sup>1</sup> According to some authorities, the rule holds that tort law offers no redress for negligence that causes only economic losses<sup>2</sup> unaccompanied by personal injuries or property damages.<sup>3</sup> However, whether a rule so expansive is part of American tort law is still open to doubt.<sup>4</sup> There are many variations of the rule,<sup>5</sup> and courts often discuss its dictates only in relationship to products liability or contractual performance. As one scholar remarked, the law of tort liability for purely economic losses is “much less well settled and less uniform than one might wish it to be.”<sup>6</sup>

#### **A. Three Areas of Concern**

An examination of the economic loss rule entails at least three areas of concern. The first is whether purely economic losses caused by a defective product are recoverable under tort law. As discussed below, there is a high degree of agreement that the answer to this question is no, absent personal injury or damage to other property.<sup>7</sup>

The second area of concern relates to whether a tort claim for economic damages is viable when there is some other contract between the parties (*e.g.*, a service contract or a contract relating to nondefective goods<sup>8</sup>) which allocates or could have allocated the risks of economic loss. As to these matters, there is a consensus that the breach of a purely contractual duty is not actionable as a tort if the only consequence is economic losses. However, that modicum of agreement quickly dissolves as application of the rule is charted. There are numerous competing formulations. For example, Colorado holds that “a party suffering only economic loss from the breach of an express or implied contractual duty may not assert a tort claim for such a breach

absent an independent duty of care under tort law.”<sup>9</sup> Wisconsin, taking a different tack, says the economic loss doctrine bars the plaintiff’s tort causes of action if the “claimed damages are the result of disappointed expectations of a bargained-for product’s performance.”<sup>10</sup> Some states endorse the view that “the economic loss doctrine is inapplicable to claims for the negligent provision of services,”<sup>11</sup> and thus apply the rule only in cases involving contracts for the sale of goods.<sup>12</sup>

The remaining area of concern is all of the rest of tort law, everything beyond defective product- or contract-related claims. In this vast residual territory,<sup>13</sup> the operation of the economic loss rule is not well charted, and whether there is a “rule” at all is a subject of contention.<sup>14</sup> Some courts have expressly held that the economic loss rule does not apply outside the defective product or contract contexts.<sup>15</sup> Other courts state the rule so broadly that they seem certain that it applies to cases in this category that have not yet been conceived.<sup>16</sup> In most states, there is precedent that is sympathetic to the idea that the economic loss rule might apply in this residual field, such as the decisions holding that negligent interference with contract is not actionable,<sup>17</sup> or case law that saves persons who cause transportation accidents from liability for the economic losses of persons relegated to alternate routes.<sup>18</sup> But it is far from resolved whether these pockets of no liability mean that there is a general rule, broadly applicable,<sup>19</sup> against tort liability for purely economic losses in contexts unrelated to product defects or contractual performance.<sup>20</sup>

## **B. Types of Tort Claims Barred**

The economic loss rule, to the extent that it is recognized, is even more expansive than first stated.<sup>21</sup> The rule generally bars strict liability<sup>22</sup> claims, as well as negligence. This makes sense because strict liability, at least in the defective products and hazardous activities contexts, is merely a doctrinal substitute for negligence principles, which may make resolution of liability issues more efficient or more certain.<sup>23</sup> In cases where purely economic losses are caused by a defective product or an abnormally dangerous activity, it is logical that if tort claims based on negligence are barred by the rule, claims based on tort strict liability should be foreclosed, too.

Some authorities have taken the extreme position that the economic loss rule precludes recovery even for purely economic losses caused by intentionally tortious conduct.<sup>24</sup> Not surprisingly, other decisions, employing various rationales, are to the contrary.<sup>25</sup> Where economic losses are deliberately inflicted via tortious conduct, there is little reason to save the defendant from liability, whether under the economic loss rule or otherwise.<sup>26</sup>

### **C. Doubts and Exceptions**

Doubts about the coherence of a generally applicable economic loss rule have frequently been raised.<sup>27</sup> Those concerns are bolstered by the fact that any broad statement of the rule must be qualified by important, well-recognized exceptions.<sup>28</sup> Not the least of these qualifications are the causes of action imposing liability for misrepresentation,<sup>29</sup> defamation,<sup>30</sup> professional malpractice,<sup>31</sup> breach of fiduciary duty,<sup>32</sup> nuisance,<sup>33</sup> loss of consortium,<sup>34</sup> wrongful death,<sup>35</sup> and spoliation of evidence,<sup>36</sup> all of which may afford recovery for negligence causing purely economic losses to the plaintiff. So too, statutory causes of action, even when

based on negligence<sup>37</sup> or strict liability<sup>38</sup> principles, usually trump the judicially designed economic loss rule.<sup>39</sup> Courts also find that negligence causing purely economic harm is actionable where there is a “special relationship” between the plaintiff and defendant.<sup>40</sup>

If the economic loss rule is held to bar intentional tort claims as well as ones founded on negligence, the list of exceptions must even be greater. Intentional tort actions based on fraud,<sup>41</sup> tortious interference with contract<sup>42</sup> or with prospective advantage,<sup>43</sup> and conversion<sup>44</sup> routinely allow recovery of purely economic losses.<sup>45</sup> Moreover, theories of secondary liability, such as aiding and abetting a breach of fiduciary duty,<sup>46</sup> may make a defendant liable to a plaintiff for purely economic harm. This multitude of exceptions means that, contrary to the view of some writers, the economic loss rule, in operation rather than theory, does not provide a “clear and predictable limit to liability.”<sup>47</sup>

#### **D. One Rule or Several?**

The truth may be that there is not one economic loss rule broadly applicable throughout the field of torts, but rather several more limited rules that govern recovery of economic losses in selected areas of the law.<sup>48</sup> For example, the rules that limit the liability of accountants to third parties for harm caused by negligence<sup>49</sup> or that save careless drivers from liability to the employer of a person injured in an auto accident<sup>50</sup> may be fundamentally distinct from the ones that bar compensation in tort for purely economic losses resulting from defective products<sup>51</sup> or misperformance of obligations arising only under contract.<sup>52</sup>

For purposes of convenience, this article will speak of the economic loss rule in the

singular, nevertheless recognizing that on the issue of whether there is one rule or several, the jury is still out. Thoughtful voices doubt whether there is a unitary theory<sup>53</sup> and are arguing against the “crystallization” of a single rule.<sup>54</sup> Indeed, American Law Institute’s project on tort liability for economic loss is now in abeyance, following the resignation of the Reporter.<sup>55</sup> None of the project’s initial drafts<sup>56</sup> was approved by the Institute.<sup>57</sup> The confusing<sup>58</sup> mass of precedent relating to tort liability for economic loss has yet to be disentangled and expressed with the clarity commonly found with respect to other tort law topics.

#### **E. Abundant Litigation**

The terms and scope of the economic loss rule may be the subject of disagreement, but there is no dispute as to the underlying reality. Recovery in tort actions today for purely economic losses is often difficult to obtain.<sup>59</sup> Indeed, the obstacles posed by the economic loss rule or related principles seem to loom ever larger.<sup>60</sup> The economic loss rule was not even taught in law schools as substantial legal principle a generation ago.<sup>61</sup> However, today it is covered in many tort casebooks<sup>62</sup> and presumably taught in many classes. Litigants regularly assert the economic loss rule as a barrier to liability,<sup>63</sup> often with success.<sup>64</sup> So great is the ferment that Chief Justice Shirley S. Abrahamson of the Supreme Court of Wisconsin noted that the economic loss doctrine was an issue before her state high court or intermediate court 47 times in a recent five-year period.<sup>65</sup> She lamented that at “the current pace, the economic loss doctrine may consume much of tort law if left unchecked.”<sup>66</sup>

## F. The Limits of the Economic Loss Rule

Of course, the obstacles to recovery posed by the economic loss rule should be no greater than the justifications upon which the rule is founded. *Cessante ratione legis cessat et ipsa lex.*

<sup>67</sup> Not surprisingly, the confusion over the terms of the rule is accompanied by further uncertainty as to the reasons for the rule.<sup>68</sup>

Part II of this article considers the justifications advanced in support of the economic loss rule, and in particular the argument that the rule performs a useful boundary-line function by determining when contract-law principles supplant the law of torts. Focusing on the boundary-line rationale, the article addresses the application of the economic loss rule in a particular range of cases. That range includes only those cases where the question is whether the defendant owes the plaintiff *no duty* under tort law *because* a contract (either with the plaintiff *or a third-party*) defines the extent of the defendant's obligation *or because contract law is the sole source of remedies* for the harm of which the plaintiff complains. Thus, in reference to the three categories of concern mentioned above,<sup>69</sup> the analysis relates mainly to categories one (sales of defective products) and two (other contractual arrangements), and not to category three (the residual range of tort cases where contractual principles are not being asserted as a limit on duty). More specifically, because the law governing claims related to defective products is so well established,<sup>70</sup> the focus here is primarily on category two.

Part III of this article probes the limits of the economic loss rule in reference to its boundary-line function in three particular respects. First, the article argues, as some courts have recognized, that the rule generally should not be an obstacle to recovery if the plaintiff was not a

party to a contract with the defendant that is alleged to be the exclusive source of duty.<sup>71</sup> Not all courts have agreed with this contention.

Second, the article asserts that hypothetical remedies under contracts that were never entered into should not bar recovery under tort principles.<sup>72</sup> If there was never an exercise of freedom to contract, there is no reason for tort law to defer to private ordering. In many instances, but certainly not all, tort law is an appropriate vehicle for remedying purely economic loss. Hypothetical contract remedies should not preclude courts from addressing the issue of whether the defendant breached a duty under tort law.

Third, courts have sometimes erred in broadly ruling that claims related to independent tort duties are barred if the damages relate to the subject matter of the contract<sup>73</sup> or involve “disappointed” commercial expectations.<sup>74</sup> The article contends that the operation of the economic loss rule in these kinds of cases (and whether relief in tort should be available notwithstanding the contract) should be guided by the principles that generally determine whether one body of law displaces another.<sup>75</sup> These principles can be deduced from the jurisprudence that determines whether federal law preempts state law, whether statutory provisions replace common law, and whether a contractual release from liability effectively waives tort rights. Remedies otherwise available under tort law should not be foreclosed merely because a claim relates to the subject matter of a contract or because the parties could have bargained over liability for the damages at issue. Rather, whether contract principles displace applicable tort remedies should depend on the terms of the parties’ agreement and whether those terms are consistent with public policy. Only where a contract expressly or by necessary implication elects to replace tort principles actually or potentially establishing an independent



duty should relief under tort law for purely economic losses be barred by the economic loss rule. Finally, Part VI urges courts to be vigilant in ensuring that an unrealistic and unwarranted endorsement of contract principles does not undermine the fault and deterrence policies that animate American tort law.

## **II. The Policy Basis for the Economic Loss Rule**

### **A. Broad, Speculative, Disproportionate or Insurable Liability**

A variety of reasons have been offered to justify the economic loss rule,<sup>76</sup> although those reasons “have not traditionally been clear.”<sup>77</sup> It is said, for example, that liability for negligence that causes only economic harm must be uncompensable under tort law because allowing such recovery would:

- expose defendants to an unlimited scope of liability;<sup>78</sup>
- impose liability for damages that are speculative;<sup>79</sup>
- result in liability that is disproportionate to fault;<sup>80</sup> or
- have a “chilling effect on non-negligent conduct.”<sup>81</sup>

These considerations carry weight, at least under some circumstances. Yet, whether they justify a general rule denying liability for negligently caused economic losses unaccompanied by personal injury or property damage is open to question. It may simply be that liability should be denied whenever damages are speculative or excessive, or where harm to the plaintiff was insufficiently foreseeable or was otherwise outside the scope of risks as to make it fair to hold the defendant liable. Indeed, general principles of damages and proximate causation already recognize these concepts, and rules are in place to guard against liability for speculative,<sup>82</sup>

excessive,<sup>83</sup> or unforeseeable losses<sup>84</sup> or losses outside the scope of risks that made the defendant's conduct negligent.<sup>85</sup> Because that is true, these considerations offer little justification for erecting a general economic loss rule. Moreover, while there is a risk that liability for negligent conduct might have a chilling effect on non-negligent conduct, "because the line between negligent and non-negligent conduct is not a clear one,"<sup>86</sup> there is no reason to think that that problem is any greater in cases involving solely economic losses than in the great mass of cases in which liability for negligence is routinely imposed.

Courts also sometimes find that liability for negligently caused economic losses should be denied because those losses were more readily insurable by the plaintiff than the defendant.<sup>87</sup> This is an important consideration, for ability to spread a loss broadly and thereby minimize its costs has been an important consideration in shaping the American tort rules governing liability.<sup>88</sup> However, it is not always the case that a negligently caused economic loss is more insurable by the plaintiff than the defendant.<sup>89</sup> Moreover, the spreading of losses is only one of many considerations that need to be taken into account in determining whether a duty of care should be recognized.<sup>90</sup> While the spreading principle can explain the rulings of courts in particular situations,<sup>91</sup> it cannot justify a generalized theory denying recovery for negligently caused pure economic losses in a wide range of cases.

## **B. Avoiding Losses and Promoting a "Healthy Attitude"**

Courts also assert that the "[a]pplication of the economic loss doctrine to tort actions between commercial parties is . . . [intended] to encourage the party best situated to assess the

risk of economic loss, the commercial purchaser, to assume, allocate, or insure against that risk.”

<sup>92</sup> This, too, is an important consideration. “[T]ort law should encourage individuals to employ available resources to protect their own interests, rather than depend upon others to save them from harm.”<sup>93</sup> Obviously, the policy has force with respect to the purchase of goods. However, outside of that arena, it is difficult to generalize because in some cases risks may be more foreseeable to the person engaging in an injurious activity than to the victim. Thus one court held that defendants were “under a duty to commercial fisherman to conduct their drilling and production in a reasonably prudent manner so as to avoid the negligent diminution of aquatic life” because the defendants were “unmistakably . . . the best cost-avoider.”<sup>94</sup>

Writers sometimes suggest that the economic loss rule promotes a sort of individual responsibility by encouraging injured persons “to make up the economic loss by doing more work the next day,”<sup>95</sup> rather than through litigation. There is merit to this idea, too, at least where the economic loss is slight. But the “healthy attitude” rationale<sup>96</sup> is hardly the basis on which to construct a rule that bars recovery for all negligently caused losses, regardless of how foreseeable or avoidable to the defendant or damaging to the plaintiff.

## **C. The Boundary-Line Function**

### **1. When Contract Principles are Prime**

If there is a convincing rationale for the economic loss rule, it is that the rule performs a critical boundary-line function, separating the law of torts from the law of contracts.<sup>97</sup> More specifically, “[t]he underlying purpose of the economic loss rule is to preserve the distinction

between contract and tort theories in circumstances where both theories could apply.”<sup>98</sup> This paper will focus on the meaning and implications of the boundary-line rationale. Further exploration of the other justifications for the economic loss rule noted above (relating to overly broad, speculative, disproportionate, or insurable liability or to who is the best risk avoider or what promotes a “healthy attitude”) will be left to other authors<sup>99</sup> or another occasion.

Purely economic losses, authorities urge, are more properly subject to resolution under contract principles, which defer to private ordering, than by reference to tort standards.<sup>100</sup>

Under the logic of private ordering:

individuals are the best judges of their own interests; individuals maximize those interests through contracts; the expectation and reliance interests created by contracts deserve protection; promoting private contracting produces a social benefit; contract law provides the framework through which the individual and social benefits are realized in practice.<sup>101</sup>

If a person wishes to be protected from economic harm, it is argued, he or she must bargain for protection and pay the price of securing those benefits.<sup>102</sup> One who fails to do so has no right to complain that another has failed to exercise care to save him or her from non-physical harm. Put differently, the economic loss rule performs a critical bargain-enforcement role in the conduct of human affairs.<sup>103</sup> “The prohibition against tort actions to recover solely economic damages for those in contractual privity is designed to prevent parties to a contract from circumventing the allocation of losses set forth in the contract by bringing an action for economic loss in tort.”<sup>104</sup>

The boundary-line justification for the economic loss rule is plausible both in common sense terms and on closer analysis. A person who teaches or practices tort law would be quite apt to explain that body of legal principles (in contrast to contract liability) as the law governing compensation for personal injuries or property damages.<sup>105</sup> While compensation is sometimes afforded by tort law for economic losses, to state broadly that tort law offers redress for carelessly caused economic losses would be both imprecise and over-inclusive. In addition, while there are certainly cases where tort law and contract law can and should offer overlapping, alternative remedies,<sup>106</sup> there must be a point at which tort law leaves off and only contract law governs. Otherwise “contract law would drown in a sea of tort,”<sup>107</sup> since tort law frequently offers potential plaintiffs more generous terms of recovery.<sup>108</sup> There would indeed be no sensible stopping point if a party to a contract could recover under tort principles merely because the other party failed to exercise care to avoid causing the first party losses of a purely economic nature.

## **2. Product-Related Economic Losses**

The boundary-line function of the economic loss rule is most clearly established in the field of products liability.<sup>109</sup> If a defective product causes *physical* harm to a person or to property *other than the product itself*, a tort action may be brought.<sup>110</sup> In contrast, if the loss is solely of an economic nature, such as where a product defect injures the product itself<sup>111</sup> or impairs the product's value,<sup>112</sup> the plaintiff ordinarily<sup>113</sup> is relegated to compensation under contract principles. Illustratively, if a person buys a can of paint and applies the paint to a door, the person has a potential tort claim (and perhaps a contract claim as well based on breach of

warranty) if toxic odors from the paint make the plaintiff sick or if the paint eats away at the door and damages that “other” property. But if the paint simply fails to adhere to the door effectively and flakes off, or quickly discolors, causing no other damage but making the paint’s purchase a waste of money, the buyer’s sole avenue for recovery is rooted in contract principles.<sup>114</sup>

The economic loss rule operates sensibly in the products-liability field because the commercial nature of the underlying transaction means that a contract-law remedy is not only feasible, but routinely available. The sale that produces the distribution of the defective product allows the parties to determine how economic risks relating to the quality of the product should be allocated and supplies default rules relating to warranties that resolves disputes if the parties do not specify particular terms of recovery.<sup>115</sup> In addition, the ubiquitous adoption of the Uniform Commercial Code (UCC) means that there is a carefully crafted statutory mechanism available for resolving economic loss claims. At least one court has found the applicability of the UCC to be pivotal. In explaining its decision not to apply the economic loss rule to service contracts, the Supreme Court of Wisconsin wrote:

Central to our decision was the fact that no body of law similar to the UCC applies to contracts for services. . . . [T]he UCC provides a “comprehensive system for compensating consumers for economic loss arising from the purchase of defective products.” . . . .

Concern about duplicating or overriding UCC provisions was an important reason this court chose to adopt the economic loss doctrine in the first place. . . .

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The abundance of products available in the American market theoretically makes it

possible for buyers to bargain for the level of economic loss protection they desire. Referring again to the previous example, a consumer can elect to purchase cheap paint or expensive paint or something in between. It is neither surprising nor unfair if “you get what you pay for.”

As explained by then-Chief Justice Benjamin K. Miller of the Supreme Court of Illinois:

The [economic loss] doctrine reflects the principle that there are varying degrees of quality, all commercially acceptable, that parties to a commercial transaction are free to bargain over if they choose. . . . Disputes later arising from the character of the materials used should be determined under principles of contract law, and should be controlled by the requirements imposed by the parties' own undertaking. In that instance, the contract itself serves best to define the parties' respective rights and obligations.<sup>117</sup>

Nevertheless, important principles limit the scope of the economic loss rule in reference to its boundary-line function. In some situations, the plaintiff never assented to the terms of the contract that the defendant asserts is the exclusive measure of duty. The question then is whether the plaintiff's rights should be limited by the terms of such an agreement. In other cases, no contract was ever entered into by the plaintiff to mitigate or eliminate the risk of economic loss, but theoretically there could have been a contract. The issue is whether the pre-loss availability of that hypothetical remedy bars recovery in tort. Finally, in other situations, the parties to a contract are subject to independent duties under tort law, but difficult questions arise as to whether the terms of a contract, or contractual silence, override those otherwise enforceable obligations. These matters are discussed below.

### **III. Limits on the Boundary-Line Function of the Economic Loss Rule**

## **A. Claims by Persons Not in Privity**

### **1. Contract Law as the Exclusive Source of Duty**

A number of courts have rejected arguments that contract principles define the extent of duty where the economic injurer and victim were not in privity.<sup>118</sup> For example, in *Russo v. NCS Pearson, Inc.*,<sup>119</sup> students who took the Scholastic Aptitude Test (SAT) sued a national testing service for economic losses caused by the negligent scoring and misreporting of SAT results. The testing service, which was under contract with the College Board, but not with the individual test takers, argued that the plaintiffs' claims were not actionable in tort because they were based on the testing service's misperformance of contractual obligations. The federal district court for the district of Minnesota rejected that defense and found that the plaintiffs stated a claim for negligence. The opinion explained: "it strikes the Court as unfair to hold . . . , as a matter of law, that Plaintiffs lack a tort remedy because the alleged tort arose in the context of the performance of a contract to which they were strangers."<sup>120</sup> The court was unpersuaded that defendant's contract with a third party defined the full extent of its obligations.

Similarly, in *A.C. Excavating v. Yacht Club II Homeowners Ass'n, Inc.*,<sup>121</sup> the Supreme Court of Colorado held that although "subcontractors [had] assumed contractual obligations with the developer and general contractor, these obligations did not and could not relieve the subcontractors of their independent duty [under state court decisions] to act without negligence in constructing the development."<sup>122</sup> Consequently, the economic loss rule did not bar a negligence action by a homeowners association against the subcontractors seeking recovery for economic losses.

Recognizing third-party rights under tort law in these types of cases does not undermine



the public policy in favor of private ordering. Rather, it merely recognizes that private ordering takes place not in a vacuum, but within a context of other obligations.<sup>123</sup> When the issue of whether economic losses are compensable relates to third-party protection, the intent of the parties is not the only relevant consideration.

Fundamental tort policies are implicated as well: compensating victims of harm; deterring wrongful conduct and providing incentives for reasonable conduct; placing losses on those who can best bear or distribute them; and fairness . . . [in] redressing harm caused to innocent parties and imposing the burden of harm on the parties responsible for it.<sup>124</sup>

With respect to the boundary-line function of the economic loss rule, decisions holding that third-party claims are not foreclosed by the rule make sense. If there is no agreement between the parties to a lawsuit, there is no risk that recognizing tort obligations will violate the parties' freedom to contract,<sup>125</sup> because there never was an effort to exercise such freedom. If the parties are not in privity, contract law does not potentially afford a remedy, except in the relatively rare case of a third-party beneficiary. Thus, respect for contract principles and private ordering does not require that the economic loss rule bar the claims of persons not standing in a contractual relationship. The purpose of the economic loss rule is not to leave injured persons remediless for economic losses, but to ensure respect for private ordering by relegating a plaintiff to contract remedies in cases where there is an agreement between the parties allocating economic risks.<sup>126</sup> If there is no contract between the parties to litigation, there is no boundary-line function to be performed by the economic loss rule.

The reason that a third person physically injured by a defective product is permitted to

sue in tort for resulting damages is that such a person “generally had neither the bargaining power nor the opportunity to bargain with its manufacturer or seller and so could not reasonably provide himself with the same kind of protection that a purchaser of goods could.”<sup>127</sup> Similarly, nonparties to a contract typically have no real opportunity (and often little power<sup>128</sup>) to bargain over protection from economic losses caused by negligent performance of the agreement. Nonparties therefore should not be precluded from suing in tort for resulting damages.

As noted above, a third-party beneficiary may have enforceable rights under contract law, even though not a party to the agreement. Does that mean that a tort claim by this category of plaintiff against a party to the contract should be barred by the economic loss rule? Presumably, the answer is no. It is one thing to defer to private ordering when the question concerns the rights of parties to an agreement. It is something else entirely to say that two parties to an agreement may limit the rights of third parties (even third-party beneficiaries) who never participated in the negotiation of the contract. If established tort principles entitle a third party to protection under tort law for economic loss, an agreement to which the third party never assented should not be permitted to vitiate his or her right to tort remedies.

## **2. Recovery by Purchasers Against Defendants Not in Privity**

Occasionally, courts have held that the economic loss rule bars a tort claim related to a contract even where the parties to the lawsuit are not in privity.<sup>129</sup> These decisions can sometimes be explained as a natural application of the economic loss rule in the context of a sale of goods, as where a disappointed purchaser of a product sues the manufacturer or wholesaler of the goods (rather than the retailer).<sup>130</sup> A purchaser seeking purely economic losses should not be permitted to complain, under tort principles, against anyone in the chain of distribution that

the product the plaintiff bought was not better (*i.e.*, more effective, more valuable, or more “reasonable”) than what the plaintiff bargained for under the law of contract. Absent fraud<sup>131</sup> or some other breach of an independent duty,<sup>132</sup> contract principles normally are the buyer’s sole remedy for purely economic loss related to purchased goods, regardless of whether the suit is against the retailer, with whom the purchaser was in privity, or against a wholesaler or manufacturer up the chain of distribution. In this type of case, it is the defendant (the manufacturer or wholesaler), rather than the plaintiff (the purchaser), who is the stranger to the final contract of sale. With respect to purely economic loss, it is not unfair to bind the plaintiff by the terms of the agreement to which the plaintiff assented.

### **3. Tort Duty Related to Performance of a Contract with Another**

Questions arise as to whether a potential defendant’s negligent performance of a contractual obligation owed to the third party can also be a breach of a tort duty to a person not in privity (the potential plaintiff).<sup>133</sup> Some cases answer this question in the negative<sup>134</sup> and inappropriately invoke the economic loss rule as a reason for denying recovery. One such case is *Plourde Sand & Gravel Co. v. JGI Eastern, Inc.*<sup>135</sup> This decision is difficult to understand from the perspective of the boundary-line function of the economic loss rule.

In *Plourde*, Hiltz, a subcontractor for a private construction project in the Town of Pembroke, hired the plaintiff to supply gravel for the purpose of constructing a roadway. Engineers employed by the town hired the defendant to test the gravel to determine whether it met the town’s specifications. The defendant erroneously determined that the plaintiff’s gravel was inadequate and the plaintiff therefore was forced to incur the costs of removing and replacing the gravel. The Supreme Court of New Hampshire held that because the plaintiff’s

negligence claim against the defendant sought only economic damages, it was barred by the economic loss rule, regardless of the fact that there was no contract between the plaintiff and defendant which could have dictated the terms of a contractual remedy.

It is hard to understand the basis for the court's decision. The court's rationale was as follows:

The policy behind . . . [the economic loss rule] is to prevent potentially limitless liability for economic losses . . . .

. . . .

Moreover, permitting economic loss recovery in tort here would blur the distinction between contract and tort law. The plaintiff is essentially alleging that the defendant negligently performed its duties under its contract with another party and that as a result, the plaintiff has lost the benefit of its bargain with Hiltz . . . .

. . . .

. . . . The economic loss the plaintiff suffered in removing and replacing the gravel arose "solely from disappointed commercial expectations" in that the plaintiff "lost the anticipated profits of its contract" with Hiltz . . . . Imposing a tort duty upon the defendant in this case would disrupt the contractual relationships between and among the various parties.<sup>136</sup>

The court's reasoning is questionable on several grounds. First, this was not a case of "potentially limitless liability." It seems entirely clear from the facts that if the testing of the gravel was negligently deficient, it would affect the provider of the gravel, not some vast class of potential plaintiffs, and that the economic losses would extend only as far as the cost of the

materials involved in the job, and no further.<sup>137</sup> Moreover, allowing a negligence claim would not “disrupt the contractual relationships between and among the various parties” because the only duty that negligence law would impose on the defendant would be to exercise care in testing the gravel. That duty would have been entirely consistent with the obligations that the defendant had already obliged itself to perform pursuant to its contract with the engineers. This is not the case of whether the court should recognize an inconsistent, competing obligation which might interfere with contractual performance.

More importantly, for purposes relating to the boundary-line function of the economic loss rule, allowing the plaintiff in *Plourde Sand & Gravel* to sue for negligence would not “blur the distinction between contract and tort law.” Contractual performance always takes place within a matrix of other legal obligations, including those imposed by the law of torts. For example, it is no defense to a tort claim alleging negligent misrepresentation causing economic loss that, at the time of the erroneous statement, the defendant was acting pursuant to a contractual relationship between the defendant and some other person.<sup>138</sup> Parties to contracts have obligations beyond those imposed by the terms of their agreements.

To be sure, in cases like *Plourde Sand & Gravel*,<sup>139</sup> there is a valid question concerning whether performance (or misperformance) of a contractual obligation owed to one person creates a tort duty of care to a third person who foreseeably may be injured. This type of question is not uncommon in tort law. Cases often present the issue of whether a person performing a contractual duty owed to one person has a duty to act to prevent *physical harm* to a third person. Courts have held, for example, that mental health professionals who learn in the course of a therapeutic relationship that a patient poses a threat of physical harm to a third person have a

duty to exercise reasonable care to prevent that harm from occurring.<sup>140</sup> Similarly, physicians have been found to have a duty to warn third persons that a patient has a communicable disease<sup>141</sup> or to inform the subject of a physical exam conducted pursuant to a contract with an employer of a diseased condition detected during the examination.<sup>142</sup>

Other cases raise the question of whether a person performing a contractual obligation owed to one person has an additional tort duty to another person to exercise reasonable care to prevent harm to the third person's *economic interests*.<sup>143</sup> The drug testing cases offer a good illustration. If a testing service hired by an employer negligently performs a drug test on an employee or job applicant, the affected test subject may be fired or rejected for employment, and in either case will suffer economic losses. A number of courts, influenced perhaps by the reduced risk of indeterminate liability<sup>144</sup> or the fact that the parties to the contract could allocate losses relating to inadvertent errors,<sup>145</sup> permit the test subject to sue the testing agency for negligence, even though there was no contract between the parties and only economic losses resulted.<sup>146</sup> A minority of courts are to the contrary.<sup>147</sup> The point here is that it is appropriate for courts to consider these types of duty questions within the context of tort jurisprudence.<sup>148</sup> Depending on the facts and the interests at stake, some duty claims will be found to be meritorious and others will not. Blindly applying the economic loss rule to bar all third-party claims related to contractual performance precludes courts from undertaking a thoughtful assessment of whether a tort duty should be recognized and how far liability should extend. Moreover, it does so without justification. Under principles of private ordering, parties to a contract may allocate risks among themselves, but they have no right to strip third parties of

whatever protection tort law provides for valuable personal interests.

## **B. Hypothetical Contract Remedies**

Cases purporting to apply the economic loss rule for boundary-line reasons sometimes seize upon the fact that the plaintiff could have contracted with a third person to address the risk that gave rise to economic loss as a reason for denying recovery in tort. Thus, some courts hold that a hypothetical contract remedy makes relief in tort unavailable.<sup>149</sup> From the standpoint of the boundary-line rationale, this type of application of the rule is seriously questionable.

In *Banknorth, N.A. v. BJ's Wholesale Club, Inc.*,<sup>150</sup> a merchant failed to protect the personal information of Visa cardholders. The data was then hacked by a third party and misused in unauthorized transactions. The foreseeable result of the merchant's negligence was that a card issuer (a bank with whom the merchant had no contract) incurred huge economic losses related to reissuing cards and reimbursing cardholders for fraudulent charges, as the bank was required to do by its agreement with Visa. The federal district court for the middle district of Pennsylvania held that the negligent merchant bore no liability for the bank's losses because the economic loss rule barred the claim. The court did not find that contract principles, rather than tort law, governed the liability of the merchant to the plaintiff. There was no contract between the issuing bank and the merchant. Rather, the court's ruling was based on the fact that the bank "could have bargained for allocating the risk of fraudulent transactions *with Visa* before signing its Visa contract."<sup>151</sup> From the perspective of tort jurisprudence, this is hardly a persuasive reason for extending the economic loss rule to bar the claim of a party not in privity with the defendant. Considerations relating to both fault and deterrence argued in favor of imposing liability on the negligent merchant.<sup>152</sup> The effect of the court's decision was to leave

blameworthy conduct unpunished and undeterred and a foreseeable victim uncompensated—all on the highly speculative ground that the plaintiff bank could have convinced a third-party, Visa, at some earlier date, to change its policy on issuer reimbursement of fraudulent charges. Tort liability should be imposed to encourage safe practices, not to ensure that careless conduct goes unremedied. Using the economic loss rule to insulate blameworthy persons, such as a negligent merchant, from liability for economic losses foreseeably caused to a third-person does not defer to private ordering. Instead, it undercuts important public policies relating to fault, deterrence, and compensation that are the basis of American tort law.

The decision of the *Banknorth* court to deprive the plaintiff of relief in a negligence action against the defendant, merely because the plaintiff could have, hypothetically, contracted with a third party (there, Visa) to reduce or eliminate its risk of economic losses from fraudulent transactions, comes perilously close to saying that contract law is the exclusive source of protection from economic losses.<sup>153</sup> That, emphatically, is not the law. American tort law routinely provides compensation for economic losses, such as lost wages and diminished earning potential in cases of physical injury,<sup>154</sup> as well as awards of solely pecuniary damages in cases involving misrepresentation, professional malpractice, defamation, breach of fiduciary duty, conversion, loss of consortium, wrongful death, and tortious interference, as mentioned earlier.<sup>155</sup> Some of those actions are based on intentionally tortious conduct, but others are founded on negligence. Tort law compensates economic losses in these cases because, within limits and subject to restrictions, it imposes duties not to inflict economic losses. While compensation for economic losses is sometimes incidental to certain forms of personal injury or property damage, either to the plaintiff or to another, many times it is not. “Tort law has traditionally protected



individuals from a host of wrongs that cause only monetary damage.”<sup>156</sup> Contract law is not the only source of compensation for economic losses, and it makes little sense to interpret the economic loss rule as though that were the presumption.

In cases such as *BankNorth*, involving extensive pecuniary harm caused by negligent data security,<sup>157</sup> there may need to be limits on the liability of a defendant who acts carelessly in order to protect the defendant from liability disproportionate to fault. Cardozo’s language from *Ultramares Corp. v. Touche*,<sup>158</sup> comes to mind. He wrote that law should not impose “liability in an indeterminate amount for an indeterminate time to an indeterminate class.”<sup>159</sup> The point here is not that there should be liability without limits, but that the economic loss rule should not be invoked based on the hypothetical possibility that the loss could have been prevented by a contract that was never formed to foreclose an inquiry into the issues of tort duty and scope of liability.

In every situation where economic losses occur, it is possible to say that the plaintiff could have entered into some type of contractual arrangement—e.g., an insurance policy, an indemnity agreement, or a release from liability—that would have mitigated the damage. To seize upon those hypothetical actions, which never came to pass, as a reason for applying the economic loss rule is to substitute imaginary remedies for real ones and pretend that the facts were other than those that actually occurred. The boundary line drawn by the economic loss rule should be between the real exercise of freedom of contract and relief under tort principles. Imaginary remedies have no place in the analysis.

In *Saratoga Fishing Co. v. J.M. Martinac & Co.*,<sup>160</sup> the Supreme Court of the United States addressed a boundary-line issue relating to the economic loss rule. The question was

whether the builder of a vessel was liable for the destruction of equipment that had been added to the vessel by an initial purchaser before it was resold to the plaintiff. The court held that the added equipment was “other property”<sup>161</sup> and that the economic loss rule did not bar recovery of tort damages. In reaching that conclusion, the court found that hypothetical contracts that might have been entered into by the builder or the purchasers were essentially irrelevant to the analysis of the case. The court wrote:

Of course, nothing prevents a user/reseller from offering a warranty. But neither does anything prevent a Manufacturer and an Initial User from apportioning through their contract potential loss of any other items—say, added equipment or totally separate physical property—that a defective manufactured product, say, an exploding engine, might cause. No court has thought that the mere possibility of such a contract term precluded tort recovery for damage to an Initial User’s other property. Similarly, in the absence of a showing that it is ordinary business practice for user/resellers to offer a warranty comparable to those typically provided by sellers of new products, the argument for . . . replacing tort law with contract law . . . is correspondingly weak. That is to say, respondents have not explained why the ordinary rules governing the manufacturer’s tort liability should be supplanted merely because the user/reseller may in theory incur an overlapping liability in contract.<sup>162</sup>

The economic loss rule should defer actual private ordering, not to a supposed preference for contract principles that is inconsistent with the important public policies that animate American tort law.

## **C. Non-Contractual Sources of Duty**

### **1. Independent Duties Under Tort Law**

In their efforts to articulate the limits of the economic loss rule, courts have focused on the source of the duty allegedly violated for the purpose of drawing a distinction.<sup>163</sup> Often, they have articulated a bright-line test.<sup>164</sup> Thus, the Supreme Court of Colorado wrote broadly:

Where there exists a duty of care independent of any contractual obligations, the economic loss rule has no application and does not bar a plaintiff's tort claim because the claim is based on a recognized independent duty of care and thus falls outside the scope of the economic loss rule.<sup>165</sup>

Elaborating on this theme, the Supreme Court of Pennsylvania quoted a decision of the Supreme Court of South Carolina with approval:

The question . . . is not whether the damages are physical or economic. Rather, the question of whether the plaintiff may maintain an action in tort for purely economic loss turns on the determination of the source of the duty plaintiff claims the defendant owed. A breach of a duty which arises under the provisions of a contract between the parties must be redressed under contract, and a tort action will not lie. A breach of duty arising independently of any contract duties between the parties, however, may support a tort action.<sup>166</sup>

Taking this approach, courts have held, for example, that actions for fraud,<sup>167</sup> negligent misrepresentation,<sup>168</sup> and conversion<sup>169</sup> are not barred by the economic loss rule because the duties not to mislead or steal are rooted in general tort principles rather than in the terms of the parties' agreement. Conversely, if the plaintiff alleges a breach of fiduciary duty, but there is no

fiduciary relationship independent of the defendant's contractual obligations, the claim will be barred by the economic loss rule.<sup>170</sup>

## **2. Purely Contractual Duties**

Focusing on the source of duty is useful because it weeds out cases involving nothing more than an alleged negligent failure to perform a purely contractual duty—a duty that would not otherwise exist.<sup>171</sup> Those types of cases should be governed by contract law. Suppose, for example, that economic losses are caused by the defendant's failure to publish a Yellow Pages ad<sup>172</sup> or monitor an alarm system<sup>173</sup> pursuant to a contract between the parties. It makes sense that the plaintiff cannot sue for negligence, for the only duties that have been breached are those created by the agreement. Similarly, if a fraud claim alleges merely that there was misrepresentation about the characteristics or quantity of the goods sold under a contract, the case involves a “mere contract claim cloaked in the language of tort,” which therefore should be decided under contract principles.<sup>174</sup> “As a general rule, a claim arising out of the provisions of a contract must find remedy under contract law.”<sup>175</sup> Put differently, “[t]he economic loss doctrine stands for the general rule that ‘ordinarily, a breach of contract does not give rise to a tort action by the promisee against the promisor.’”<sup>176</sup>

Holding that a breach of a purely contractual duty is actionable only under contract law promotes the “efficient revelation of asymmetric information.”<sup>177</sup> This is true because in contract law there is no liability for consequential economic damages without notice of special circumstances. Employing the economic loss rule to prevent recovery of economic damages in

tort forces parties to a contract to reveal relevant information that enables those with whom they deal to assess how much care should be exercised to prevent a loss.<sup>178</sup> However, the same analysis does not apply when an independent duty is imposed under tort law, because in that case there has been a judicial determination that considerations relating to fault, deterrence, personal responsibility, and compensation warrant the imposition of liability. In other words, those factors outweigh whatever other general concerns the law might have relating to the need for incentives to facilitate disclosure of relevant information.

Permitting an action for economic losses based on an independent tort duty does not necessarily mean that the defendant will be liable. Courts may still enquire into all of the considerations which are taken into account in determining whether a tort duty of care exists.<sup>179</sup> Absent a finding of an independent tort duty<sup>180</sup> (and breach<sup>181</sup>), the plaintiff has no cause of action.

### **3. Relationship to the Subject Matter of the Parties' Contract**

The clarity of the independent duty rule is sometimes eviscerated by holdings that provide that even if the breached duty arises from tort principles, the action is still barred by the rule if losses relate to the subject matter of the contract.<sup>182</sup>

The application of the economic loss rule should not turn on whether the plaintiff's damages are related to the subject matter of the contract.<sup>183</sup> To so hold is to formulate a rule that is much too broad. Consider, for example, the case of legal representation of a client by a lawyer in a personal injury case pursuant to a retainer agreement. Conduct by the lawyer amounting to misrepresentation, professional negligence, or false defamatory statements may be

related, in a real sense, to the subject matter of a contract. Yet, those claims are not,<sup>184</sup> and should not be, barred by the economic loss rule. Indeed, it would be both odd and unrealistic to expect clients to bargain with lawyers about not being misled, incompetently represented, or defamed.<sup>185</sup>

Moreover, it is easy to see how an exception based on the “subject matter of the contract” could easily be manipulated. In *Highland Crusader Offshore Partners, L.P. v. LifeCare Holdings, Inc.*,<sup>186</sup> tort claims relating to a fee triggered by an amendment to a credit agreement were allowed to go forward. The federal district court for the northern district of Texas found that because the credit agreement never mentioned or provided for an amendment fee, the plaintiffs’ loss was “not the subject matter of the contract.”<sup>187</sup> The court might just as easily have interpreted the subject matter requirement differently and concluded that the amendment and fee both related to the credit agreement, which was the subject matter of the contract, and that, therefore, the action was barred by the economic loss rule. No purpose is served by endorsement of a legal test that is so susceptible to manipulation.

#### **4. Contractual Preemption of Tort Law**

A more useful approach to ascertaining whether contract law should displace tort principles in a case where there is an independent tort duty is to think in terms of established notions of preemption because that is what is actually taking place: contract law is preempting tort law. Put differently, the boundary line between what is actionable in tort and what is actionable in contract is being moved.

There are at least three useful points of reference. The first concerns preemption of state law by federal law, another concerns displacement of common law by statutes, and the third

relates to written releases from tort liability. Each of these sources of guidance suggests that preemption of established tort principles should be recognized only in limited circumstances.

Federal law does not preempt state tort law unless that is the “clear and manifest” purpose of Congress.<sup>188</sup> Absent such a showing, a plaintiff is not deprived of state tort claims. The text of a law can expressly state Congress’s intent to preempt or, in limited cases, that intent can be implied from the language and structure of a statute.<sup>189</sup> However, there is generally a presumption against preemption by federal law.<sup>190</sup> Recognizing that state tort law serves a useful purpose as the primary source of tort remedies, courts are reluctant to hold that federal preemption alters the balance between freedom of action and liability that has been carefully crafted by a matrix of state statutes and common law decisions.

Likewise, statutory law replaces common law principles only when that is the necessary implication of the actions of the legislature. As one authority on New York state law explains:

Where a change in the common law is to be effectuated the legislative intent to do so must be clearly and plainly expressed. When . . . a statute is intended to abrogate a common law right or to confer a right not vested by the common law, it will be so construed as not to go beyond the letter; and not even to that extent unless it appears to be according to the spirit and intention of the act.<sup>191</sup>

Similarly, contractual releases from tort liability are strictly construed because they threaten to undermine the important public policies relating to fault, proportionality, deterrence, individual responsibility, and compensation that form the intellectual foundations of tort law.<sup>192</sup> A release from liability for physical harm is not valid unless it is clear, specific, and consistent with the public interest.<sup>193</sup> A release is not expansively construed to abrogate the plaintiff’s

rights under tort law merely because the release is a contract.<sup>194</sup> Rather, the plaintiff's rights under tort law are waived only to the extent that the contract so provides, and only if the waiver is consistent with public policy<sup>195</sup> and fair to the plaintiff. If these limitations regularly apply to releases in personal injury or property damage suits, it is difficult to see why the same should not be true with respect to purely economic losses. It is hard to draw a persuasive distinction between personal injury or property damage suits, on one hand, and economic loss suits, on the other, based on the degree of harm to the plaintiff.<sup>196</sup> Economic losses can be devastating, sometimes much more so than minor personal injury or damage to tangible personal property.

These lessons relating to federal law preemption, statutory supercession of common law, and written releases from liability suggest a useful approach to dealing with issues relating to the boundary-line function of the economic loss rule. Federal law must manifest a clear purpose to preempt state tort remedies; statutory law supersedes common law only to the extent necessary to give effect to the statute; and a release from liability must clearly waive the plaintiff's rights in order to obviate redress under tort law. So, too, it makes sense to hold that, with respect to the economic loss rule, the terms of a contract between the parties abrogate otherwise applicable tort principles only if the agreement clearly evidences an intent to do so or if such displacement is a necessary consequence of the validity of the agreement. Further, even if these conditions are met, relinquishment of rights under tort law should be recognized only when depriving the plaintiff of those rights is consistent with public policy.<sup>197</sup> Boiler plate provisions in standard-form contracts should be subject to careful scrutiny.<sup>198</sup>

There is no reason for the law to presume that the parties to a contract have bargained to relinquish rights that arise under tort law.<sup>199</sup> When economic losses relate to the terms of a



contract and the plaintiff alleges violation of a contractual duty, the plaintiff should be permitted to pursue tort remedies unless the contract expressly or by necessary implication has waived such rights. This approach to defining the boundary-line between contract and tort is not a startling departure from current practice, but in fact a clearer, more useful description of what some courts are already doing. Consider the example above relating to the amendment of the credit agreement.<sup>200</sup> The court held that tort remedies were available because the credit agreement never mentioned or provided for an amendment fee. In effect, the court was saying that the parties' contract was insufficiently specific to displace tort remedies relating to such an amendment because the subject was never addressed. There was no express or implicit preemption of tort remedies.

## **5. Disappointed Expectations**

Courts sometimes hold that the economic loss rule applies because a plaintiff's claim involves merely disappointed expectations arising from the plaintiff's bargain with the defendant.<sup>201</sup> For example, in *Grams v. Milk Products, Inc.*,<sup>202</sup> the Supreme Court of Wisconsin addressed the issue of whether farmers who fed their calves a non-medicated version of a milk substitute could recover in tort from the product's manufacturer and distributor for physical harm (poor growth and a higher mortality rate) allegedly suffered by the calves. The court held that even though the allegedly defective product had caused harm to "other property,"<sup>203</sup> which normally is compensable, the tort claims were barred by the economic loss rule. The majority concluded: "if claimed damages are the result of disappointed expectations of a bargained-for product's performance . . . the plaintiff must rely upon contractual remedies alone."<sup>204</sup>

On the facts of the case, the decision is explainable and perhaps understandable. The plaintiffs, upon enquiring about a cheaper milk substitute, had opted to use one without medication which sold for a lower price than the medicated version.<sup>205</sup> The court found that the claimed economic damages were “within the scope of the bargaining”<sup>206</sup> between the parties. Therefore, contract law provided the exclusive remedy. As the court explained:

The record shows that the expected function of the milk replacer was to provide sustenance for the Grams’ calves. The Grams expected that the . . . non-medicated replacer would properly nourish the calves, much as the old replacer had, so that the calves would grow. This bargain was not about milk replacer *per se*; it was about a product that would foster the healthy development and growth of young calves.

What is troubling about *Grams* is not so much the result, but rather the court’s endorsement of fragmentary language from a Michigan case stating that tort claims are barred by the economic loss rule if “the damage was within the scope of bargaining *or . . . ‘the occurrence of such damage could have been the subject of negotiations between the parties.’*”<sup>207</sup> There is a great difference between harm that was “within the scope of bargaining” and harm that “could have been” bargained over. That difference should be legally significant. While the former situation is a proper occasion for preempting tort principles based on deference to private ordering, the latter situation is not because in that case displacement of tort remedies was neither expressly provided for by the agreement of the parties nor the subject of actual bargaining.

Interestingly, the full quotation from the Michigan case (*Neibarger v. Universal Coops, Inc.*<sup>208</sup>) is more limited in its reach than the fragmentary, but seemingly pivotal, reference in

*Grams*. The *Neibarger* court had written: “Where damage to other property was caused by the failure of a product purchased for commercial purposes to perform as expected, *and this damage was within the contemplation of the parties to the agreement*, the occurrence of such damage could have been the subject of negotiations between the parties.”<sup>209</sup>

The *Grams* decision expressed its holding in terms of a “disappointed expectations” test.<sup>210</sup> The use of such language for determining whether contract law precludes analysis of liability under tort principles is inappropriate. The expression “disappointed expectations” is imprecise and much too broad. There are many cases where a plaintiff’s commercial expectations are indeed “disappointed” and yet the economic loss rule does not bar relief in tort. For example, if a potential defendant commits fraud in the inducement incidental to a contract with the plaintiff, the plaintiff is sure to suffer “disappointed expectations,” yet most states permit suit in tort.<sup>211</sup> It would be preferable to avoid the language of “disappointed expectations” and to inquire directly into whether the harm in question was within the scope of the actual bargaining by the parties and whether recovery in tort was expressly or implicitly foreclosed by the plaintiff’s entry into the contract.

The careless, fragmentary quotation from *Neibarger* incorporated into the *Grams* decision has launched courts on an unfortunate and misguided line of inquiry. Wisconsin courts have interpreted *Grams* to mean that:

The “disappointed expectations” test is directed at determining whether the purchaser should have anticipated the need to seek protection against loss through contract. This test focuses on the expected function of the product and whether, from the purchaser’s perspective, it was reasonably foreseeable that the product

could cause the damage at issue . . . .

. . . . Because the focus is on “reasonable foreseeability,” it follows that an objective standard applies: Should a reasonable purchaser in the plaintiff’s position have foreseen the risk?<sup>212</sup>

Under this formulation, respect for private ordering based on the actual conduct of the parties to the contract is replaced by an across the board preference for contract remedies in any case involving a foreseeable risk of economic harm. This is unwise for several reasons. First, any claim for liability based on negligence, or even on theories of intentional tort liability, must, by definition, involve foreseeable harm. The same is even sometimes true of strict liability claims.<sup>213</sup> Thus, the proffered formulation sweeps so widely in addressing foreseeable economic harm that it does not draw the boundary line between contract law and tort law, but rather substitutes contract law for tort law in a wholesale manner. Doing so is imprudent because it undercuts the principles of fault, deterrence, proportionality, and fair compensation that properly find application in cases when questions of duty and scope of liability are resolved by reference to well established tort principles. As explained above, tort law frequently provides redress for economic harm,<sup>214</sup> and there is no reason to assume that even pure economic harm is compensable only under contract principles. Second, the formulation in question, which relegates persons to contract remedies for foreseeable economic loss, is often impractical and unworkable for the reasons related to lack of bargaining power or information, as explained below.

#### **D. Lack of Bargaining Power**

In their construction and application of the economic loss rule, courts have repeatedly

emphasized the inappropriateness of employing the rule to bar the claims of persons who never had a real opportunity to bargain for contractual protection for economic losses. Thus, the Supreme Judicial Court of Massachusetts has remarked that “[w]hen the economic loss rule has been applied, the parties usually were in a position to bargain freely concerning the allocation of risk.” Similarly, in another case, Chief Justice Miller of the Illinois Supreme Court explained:

The cases in which . . . [the economic loss doctrine] has been applied are grounded on the notion that the complaining party, if he wished protection against the particular type of harm suffered, could have bargained for a guarantee or warranty against it. It is difficult to apply that concept in the area of legal representation, where the purpose of retaining counsel is to obtain a representative who will function as a fiduciary and will act professionally, with reasonable skill and ability, to advance the client's interests.<sup>215</sup>

Concerns about lack of bargaining power explain why many courts have found the economic loss rule inapplicable to tort actions against professionals. However, the problem of lack of bargaining power is more widespread.

Although some persons have argued that contractual principles should supplant contemporary tort law in a wide range of circumstances,<sup>216</sup> the history of American law in the twentieth century<sup>217</sup> counsels the exercise of caution to courts and legislatures faced with those entreaties.<sup>218</sup> Contractual bargaining over protection from economic harm is often slow, difficult, and expensive, and, in many cases, a practical impossibility. Consumers engage in multitudinous transactions, and they often lack important information about the risks they face to be able to negotiate intelligently over protection from those dangers. As one court recently

noted, “[i]t goes without saying that many individual consumers have no meaningful ability to negotiate with product manufacturers and distributors.”<sup>219</sup> Of equal importance, the persons with whom consumers conduct transactions—cashiers at discount stores, registrars in university bursars’ offices, and agents at rental car counters—typically lack authority, training, or incentives to vary the terms of what are essentially intended to be take-it-or-leave-it transactions.

Tort law can offer a more efficient path than contract law to deterring and compensating some forms of economic harm. Consider for example the problems posed by failure to protect computerized personal information and the resulting losses caused by identity theft. Because of the numerous entities which maintain databases (e.g., credit card issuers, universities, governmental agencies, and social networking websites), it would be virtually impossible for any individual to negotiate with all relevant database possessors over the duty to exercise care to protect personal information from unauthorized access. However, the recognition of a tort duty obliging database possessors to protect personalized information from hacking has the potential to encourage safe practices by a wide range of potential defendants, as well as provide a mechanism for distributing losses when they occur.<sup>220</sup> Contract law principles could not be nearly as efficient in performing that role.

Relegating persons to exclusively contract remedies for purely economic losses will effectively immunize defendants from liability in a wide range of cases. This is undesirable for, in many cases, unnecessary economic harm should be deterred through legal principles that create an incentive for safe practices through risk of liability.

#### **E. Waiver of the Economic Loss Rule**

Insofar as its boundary-line function is concerned, the economic loss rule is premised on a preference for private ordering. It, therefore, makes sense that the protections afforded by the rule must be subject to waiver by agreement of the parties. In *PNC Bank, National Ass'n v. Colonial Bank, N.A.*,<sup>221</sup> a loan participation agreement expressly provided that the defendant would not be liable "except for . . . material breach of this Agreement or its own gross negligence, bad faith or willful misconduct."<sup>222</sup> The federal district court for the middle district of Florida concluded that the "plain meaning" of the language of the agreement controlled and, therefore, the defendant "effectively waived any protection that the economic loss doctrine may have afforded it with regard to an action based on negligence, bad faith or wilful misconduct."<sup>223</sup>

#### **IV. Conclusion**

The economic loss rule performs a valuable function in determining which economic losses are actionable only under contract law and not under tort principles.<sup>224</sup> However, just as contract law should not be allowed to drown in a "sea of tort,"<sup>225</sup> the principles of tort law should not be permitted to drown in a "sea of contract."<sup>226</sup> It is essential that the economic loss rule be crafted and applied in a manner that adequately accommodates the "goals of tort [law]—deterrence of negligent conduct, interpersonal considerations of fairness, and compensation—that support liability"<sup>227</sup> in compelling cases. Unfortunately, attainment of this objective entails a high degree of doctrinal complexity. As Professor Robert Rabin has remarked:

[I]t would undoubtedly be more aesthetically satisfying to have an economic loss

rule that could be invoked without micro-scrutiny of competing policy considerations . . . . But bright-line rules grounded in single-dimension justifications would lead to undesirable policy outcomes.<sup>228</sup>

In interpreting and applying the economic loss rule in cases involving contractual relationships, the rule's boundary-line function can be properly performed only by focusing on the actual conduct of the parties to the litigation—what they did, not what they might have done. Only where those parties have in fact engaged in private ordering to supplant tort remedies, should relief under tort law be foreclosed by the rule as a matter of law.<sup>229</sup> Hypothetical remedies under contract law and a supposed preference for contractual allocation of economic risks have no place in the analysis.<sup>230</sup> The determinative factor is the actual conduct of the parties.

An agreement to which the plaintiff is not a party provides no basis for limiting whatever rights the plaintiff may have under tort law.<sup>231</sup> Similarly, if the defendant has breached a tort duty that arises independent of contractual obligations,<sup>232</sup> that breach should be actionable unless the parties' contract expressly or by necessary implication preempts such relief.<sup>233</sup> The fact the economic losses are related to the subject matter of the contract<sup>234</sup> or involve disappointed commercial expectations<sup>235</sup> is irrelevant unless the facts establish that actual private ordering has foreclosed relief in tort.

Expansive application of the economic loss rule to bar recovery under tort law in cases where the parties to a contract theoretically could have, but did not, engage in private ordering, neither defers to the conduct of the parties nor offers a remedy that adequately accommodates the



public interest in deterring unnecessary injurious conduct and forcing those at fault to bear the costs associated with their activities. The boundary line between tort law and contract law must be fixed by reference to what the parties actually agreed in their relations with one another.

\* Visiting Professor of Law, The George Washington University Law School; Professor of Law, St. Mary's University, San Antonio, Texas. B.A., LL.D., St. Vincent College (Latrobe, Pa.); J.D., University of Notre Dame; LL.M., Yale University. Professor Johnson is a co-author of *Studies in American Tort Law* (3d ed. 2005) (with Alan Gunn). Research and editorial assistance were provided by four law students, Francesco A. Savoia, S. "Collanne" Bramblett, Heather Mae Sala, and Bharath Reddy Jutur.

<sup>1</sup> See Jay M. Feinman, *The Economic Loss Rule and Private Ordering*, 48 Ariz. L. Rev. 813 (2006); Oscar S. Gray, *Some Thoughts on "The Economic Loss Rule" and Apportionment*, 48 Ariz. L. Rev. 897 (2006). See also Anita Bernstein, *Keep It Simple: An Explanation of the Rule of No Recovery for Pure Economic Loss*, 48 Ariz. L. Rev. 773 (2006); Ellen M. Bublick, *Economic Torts: Gains in Understanding Losses*, 48 Ariz. L. Rev. 693 (2006); Dan B. Dobbs, *An Introduction to Non-Statutory Economic Loss Claims*, 48 Ariz. L. Rev. 713 (2006); Mark P. Gergen, *The Ambit of Negligence Liability for Pure Economic Loss*, 48 Ariz. L. Rev. 749 (2006); David Gruning, *Pure Economic Loss in American Tort Law: An Unstable Consensus*, 54 Am. J. Comp. L. 187 (2006); Thomas J. Miles, *Posner on Economic Loss: EVRA Corp v. Swiss Bank*, 74 U. Chi. L. Rev. 1813 (2007); Ellen S. Pryor, *The Economic Loss Rule and Liability Insurance*, 48 Ariz. L. Rev. 905 (2006); Robert L. Rabin, *Respecting Boundaries and the Economic Loss Rule in Tort*, 48 Ariz. L. Rev. 857 (2006).

<sup>2</sup> "The term 'economic loss' refers to damages that are solely monetary, as opposed to damages involving physical harm to person or property." *Giles v. General Motors Acceptance Corp.*, 494 F.3d 865, 873 (9th Cir. 2007).

<sup>3</sup> See *Adams v. Copper Beach Townhome Communities, L.P.*, 816 A.2d 301, 305 (Pa. Super. Ct. 2003) (stating that "[t]he Economic Loss Doctrine provides that no cause of action exists for negligence that results solely in economic damages unaccompanied by physical injury or property damage," and that employees' claims for lost wages resulting from the shutdown of a plant caused by flooding for which defendants were allegedly responsible);

Zurich American Ins. Co. v. Hughes, Watters & Askanase, L.L.P., 2006 WL 1914689, \*2 (Tex. App.–Eastland 2006) (stating that “[t]he economic loss rule provides that, in tort cases, economic damages are not recoverable unless they are accompanied by actual physical injury or property damage”). *See also* Sovereign Bank v. BJ’s Wholesale Club, Inc., 533 F.3d 162, 175-78 (3d Cir. 2008) (holding that the economic loss rule barred a negligence claim by a bank against a merchant that failed to protect cardholder information because the action sought damages only for economic losses, including the costs of issuing new debit cards and reimbursing cardholders for unauthorized charges; Banknorth, N.A. v. BJ’s Wholesale Club, Inc. 442 F. Supp.2d 206, 208 (M.D. Pa. 2006) (similar); In re TJX Companies Retail Sec. Breach Litigation, 524 F. Supp.2d 83, 92 (D. Mass. 2007) (similar); Pa. State Employees Cr. U. v. Fifth Third Bk., 398 F. Supp. 2d 317, 326-330 (M.D. Pa. 2005) (similar); 532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Center, Inc., 727 N.Y.S.2d 49, 55 (N.Y. 2001) (holding, in a case where a construction collapse resulted in street closures and adversely affected the plaintiffs’ local businesses, plaintiffs’ negligence claims based on economic loss alone fall beyond the scope of the duty owed them by defendants and should be dismissed”). *See generally* Feinman, *supra* note 1, at 813 (opining that “[t]he most general statement of the economic loss rule is that a person who suffers only pecuniary loss through the failure of another person to exercise reasonable care has no tort cause of action against that person”); Ann O’Brien, Note, *Limited Recovery Rule as a Dam: Preventing a Flood of Litigation for Negligent Infliction of Pure Economic Loss*, 31 Ariz. L. Rev. 959, 959 (1989) (asserting that “[u]nder the majority rule, a plaintiff may recover economic losses for negligence only when there is accompanying physical damage to person or property”).

<sup>4</sup> *See* Giles v. General Motors Acceptance Corp., 494 F.3d 865, 874-75 (9th Cir. 2007) (stating that “many courts have stated in overly broad terms that purely economic losses cannot be recovered in tort” and that “[s]uch broad statements are not accurate”).

Professor Oscar S. Gray, a leading torts scholar, has expressed misgivings about attempts to formulate a unified economic loss rule. *See* Gray, *supra* note 1, at 901-02. He wrote:

I had not previously thought that there was any such thing as a single “economic loss rule.” Instead, I had thought that there was a constellation of somewhat similar doctrines that tend to limit liability, in the case of purely economic loss, from what might have been expected under *Palsgraf* in the case of physical loss. These doctrines seemed to work in somewhat different ways in different contexts, for

similar but not necessarily identical reasons, with exceptions where the reasons for limiting liability were absent.

*Id.* at 898.

<sup>5</sup> *Cf.* Pryor, *supra* note 1, at 915 (reporting that “different versions of the economic loss rule exist”).

<sup>6</sup> Herbert Bernstein, *Civil Liability for Pure Economic Loss Under American Tort Law*, 46 Am. J. Comp. L. 111, 125 (1998).

<sup>7</sup> *See* Part II-C-2.

<sup>8</sup> *See* Part III-C-2.

<sup>9</sup> *Town of Alma v. Azco Const., Inc.*, 10 P.3d 1256, 1264 (Colo. 2000)

<sup>10</sup> *Grams v. Milk Products, Inc.*, 699 N.W.2d 167, 180 (Wis. 2005) (holding that tort claims relating to injuries sustained by calves who were fed with a defective milk substitute were barred by the economic loss rule).

<sup>11</sup> *See Insurance Co. of North America v. Cease Elec. Inc.*, 276 Wis.2d 361, 688 N.W.2d 462, (Wis. 2004). *See also* *America v. American Aviation, Inc.*, 891 So.2d 532, 544-45 (Fla. 2004) (Cantero, J., concurring) (stating that “the economic loss rule does not apply in the services context unless a contract exists and none of the established exceptions to the rule apply” and indicating that “[t]he vast majority of states restrict the rule to products cases, at least in the absence of a contract”). *But see Fireman’s Fund Ins. Co. v. SEC Donohue, Inc.*, 679 N.E.2d 1197, 1200 (Ill. 1997) (stating that “[t]he policy interest supporting the ability to comprehensively define a relationship in a service contract parallels the policy interest supporting the ability to comprehensively define a relationship in a contract for the sale of goods. It is appropriate, therefore, that [the economic loss doctrine] should apply to the service industry”); *Banknorth, N.A. v. BJ’s Wholesale Club, Inc.* 442 F. Supp.2d 206, 212 (M.D. Pa. 2006) (agreeing that the economic loss rule can be extended to service contracts).

<sup>12</sup> The product versus service distinction is also crucial in the law of products liability, and the jurisprudence from that area would presumably inform cases dealing with the same issue for purposes of the economic loss rule. *See* Charles E. Cantu, *A New Look at an Old Conundrum: The Determinative Test for the Hybrid Sales/Service Transaction Under Section 402A of the Restatement (Second) of Torts*, 45 Ark. L. Rev. 913 (1993).

<sup>13</sup> *See* Bernstein, *supra* note 1, at 782-93 (discussing the taxonomy of claims for unintentionally inflicted

economic loss and identifying, beyond the category of cases involving “a contract-like relation between plaintiff and defendant,” two other categories involving “impediments to the plaintiff’s regular business operations” (e.g., by damage to utility lines, public environments, and infrastructures, or by evacuations and closures) and “emotions mixed with financial loss” (e.g., defamation and wrongful death)).

<sup>14</sup> *But see* Dobbs, *supra* note 1, at 714 (asserting that “[s]ubject to qualifications, one not in a special or contractual relationship owes no duty of care to protect strangers against stand-alone economic harm”).

<sup>15</sup> *See* Indemnity Ins. Co. of North America v. American Aviation, Inc., 891 So.2d 532, 543 (Fla. 2004) (holding that cases that do not fall into the categories of products liability and contractual privity “should be decided on traditional negligence principles of duty, breach, and proximate cause”). *See also* Giles v. General Motors Acceptance Corp., 494 F.3d 865, 873 (9th Cir. 2007) (stating that “[s]ome jurisdictions have yet to apply the economic loss doctrine outside the product liability context”).

<sup>16</sup> *See* Adams v. Copper Beach Townhome Communities, L.P., 816 A.2d 301, 305 (Pa. Super. Ct. 2003) (stating the rule broadly and barring a claim for lost wages resulting from a plant shutdown).

<sup>17</sup> *See* Restatement (Second) of Torts §766C (1979).

<sup>18</sup> *See* Petitions of Kinsman Transit Co. (Kinsman II), 388 F.2d 821, 824-25 (2d Cir. 1968) (denying recovery of alternate transportation cost incurred by third parties as the result of the negligent destruction of a bridge).

<sup>19</sup> *Cf.* Bernstein, *supra* note 1, at 809 (stating that “[e]conomic loss is a category of encyclopedic breadth within Torts. Because business entities as well as human beings can experience economic loss, the number of potential litigants and the dollar value of damages that could be alleged are both larger than their counterparts in personal-injury litigation”).

<sup>20</sup> *Cf.* Indemnity Ins. Co. of North America v. American Aviation, Inc., 891 So.2d 532, 542 (Fla. 2004) (emphasizing the “genuine, but limited” value of the economic loss rule).

<sup>21</sup> *See* Stewart I. Edelstein, *Beware the Economic Loss Rule*, 42-Jun Trial 42, 42 (2006) (stating that under the economic loss rule “[d]amages for economic loss are not recoverable on [any] tort theory when unaccompanied by physical property damage or personal injury”).

<sup>22</sup> *See* East River Steamship Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 876 (1986) (rejecting a strict

products liability claim in admiralty for pure economic loss); *Aldrich v. ADD Inc*, 770 N.E.2d 447, 454 (Mass. 2002) (holding that in Massachusetts, in accordance with the majority of jurisdictions that have considered this issue, . . . "purely economic losses are unrecoverable in tort and strict liability actions in the absence of personal injury or property damage," but finding that a claim against architects based on negligent design was not barred because the plaintiffs alleged that water leakage caused property damage). *Grams v. Milk Products, Inc.*, 699 N.W.2d 167, 170 (Wis. 2005) (holding that claims for "strict liability tort" and "strict responsibility misrepresentation" were barred).

<sup>23</sup> See Vincent R. Johnson & Alan Gunn, *Studies in American Tort Law* 657 (3d ed. 2005) (discussing the policy basis for strict liability).

<sup>24</sup> See *Grams v. Milk Products, Inc.*, 699 N.W.2d 167, 170 (Wis. 2005) (holding that a claim for intentional misrepresentation was barred). But see *Indemnity Ins. Co. of North America v. American Aviation, Inc.*, 891 So.2d 532, 543 n.3 (Fla. 2004) (stating that "[i]ntentional tort claims such as fraud, conversion, intentional interference, civil theft, abuse of process, and other torts requiring proof of intent generally remain viable either in the products liability context or if the parties are in privity of contract" because "a rule barring recovery for economic loss 'is not an escape hatch from intentional commercial torts'").

<sup>25</sup> See *Gulf Coast Produce, Inc. v. American Growers, Inc.*, 2008 WL 660100, \*4 (S.D. Fla. 2008) (inapplicable to conversion claim); *Carran v. Morgan*, 510 F. Supp.2d 1053, 1060-61 (S.D. Fla. 2007) (inapplicable to breach of fiduciary duty, constructive trust, fraud and conversion claims). See also *Giles v. General Motors Acceptance Corp.*, 494 F.3d 865, 875 (9th Cir. 2007) (stating that "[m]any courts have explicitly refused to extend the economic loss doctrine beyond the product liability context or beyond claims for negligence and strict liability").

<sup>26</sup> See Gruning, *supra* note 1, at 187 (stating that "[s]ometimes compensation for economic losses presents no special difficulty. This is so, for example, when economic losses follow an intentional tort whose goal was to produce that very harm").

<sup>27</sup> See *Colleton Preparatory Academy, Inc. v. Hoover Universal, Inc*, 2007 WL 5433193, \*3 (S.C. 2008) (noting that the court had "continually expressed uneasiness with the economic loss doctrine that, as a result, the court had "partially rejected the rule in the residential home building context, leaving it viable in situations where a builder violates only a contractual duty"). Some courts have argued that the term "economic loss rule" causes confusion. In

Town of Alma v. Azco Const., Inc., 10 P.3d 1256, 1262-63 (Colo. 2000) (observing that “[t]he phrase ‘economic loss rule’ necessarily implies that the focus of the inquiry under its analysis is on the type of damages suffered by the aggrieved party. However, the relationship between the type of damages suffered and the availability of a tort action is inexact at best”). *See also* Pryor, *supra* note 1, at 905 (noting that one of the challenges to restating the economic loss rule is “whether its normative bases are coherent (both for the rule and for its ‘exceptions’)”).

<sup>28</sup> *See generally* Vincent R. Johnson, *Cybersecurity, Identity Theft, and the Limits of Tort Liability*, 57 S.C. L. Rev. 255, 302-03 (2005) (discussing exceptions and limitations to the economic loss rule).

<sup>29</sup> *See, e.g.*, Level 3 Communications, LLC v. Liebert Corp., 2008 WL 2908933 (10th Cir. 2008) (holding that the economic loss rule did not bar a negligent misrepresentation claim); *In re TJX Companies Retail Sec. Breach Litigation*, 524 F. Supp.2d 83, 92 (D. Mass. 2007) (similar); *ATM Exchange, Inc. v. Visa Intern. Service Ass’n*, 2008 WL 3843530 (S.D. Ohio 2008) (similar); *Bilt-Rite Contractors, Inc. v. The Architectural Studio*, 866 A.2d 270, 285 (Pa. 2005) (similar); *but see* *Smith v. John Hancock Ins. Co.*, 2008 WL 4072585, \*8 (E.D. Pa. 2008) (holding that a claim for negligent misrepresentation was barred by the economic loss rule). *See generally* Restatement (Third) of Torts: Liability for Economic Loss § 10 (P.D. No. 1 2005) (discussing liability for negligent misstatements).

<sup>30</sup> The constitution only requires proof of negligence as to falsity in a libel or slander action brought by a private person suing with regard to a matter of public concern. *See* *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 347 (1974) (stating that “so long as they do not impose liability without fault, the States may define for themselves the appropriate standard of liability for a publisher . . . of defamatory falsehood injurious to a private individual”). The culpability requirement in cases involving matters of private concern has not been definitively resolved by the United States Supreme Court, but it is certainly not higher than negligence. *Cf.* *Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc.*, 472 U.S. 749, 781 (1985) (Brennan, J., dissenting) arguing that neither the parties nor the lower courts suggested that an actual malice standard applied). The damages recoverable in defamation actions where negligence is shown include economic losses. *Cf.* *Gertz*, 418 U.S. at 349 (stating that constitutional principles “restrict defamation plaintiffs who do not prove knowledge of falsity or reckless disregard for the truth to compensation for actual injury . . . [which] is not limited to out-of-pocket loss”).

*See also* Travis M. Wheeler, Note, *Negligent Injury to Reputation: Defamation Priority and the Economic Loss Rule*, 48 Ariz. L. Rev. 1103, 1103-04 (2006) (discussing the application of the economic loss rule to “cases in which

plaintiffs seek reputational damages without pleading defamation”).

<sup>31</sup> This includes at least: legal malpractice (*see* *Resolution Trust Corp. v. Holland & Knight*, 832 F. Supp. 1528, 1532 (S.D. Fla. 1993) (rule inapplicable); *Collins v. Reynard*, 607 N.E.2d 1185, 1187 (Ill. 1992) (rule inapplicable); *Clark v. Rowe*, 701 N.E.2d 624, 627 (Mass. 1998) (stating that the “general rule in this country is that the economic loss rule is inapplicable to claims of legal malpractice”); *but see* *Zurich American Ins. Co. v. Hughes, Watters & Askanase, L.L.P.*, 2006 WL 1914689, \*4 (Tex. App.-Eastland 2006) (holding that the rule barred an insurer’s subrogation claim for legal malpractice)); accounting malpractice (*see* *Congregation of the Passion, Holy Cross Province v. Touche Ross & Co.*, 636 N.E.2d 503, 514 (Ill. 1994)); and engineering malpractice (*see* *Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc.*, 463 S.E.2d 85, 89 (S.C. 1995); *but see* *Fireman’s Fund Ins. Co. v. SEC Donohue, Inc.*, 679 N.E.2d 1197, 1200-01 (Ill. 1997)). *See also* *Southwestern Bell Telephone Co. v. DeLanney*, 809 S.W.2d 493, 494 n.1 (Tex. 1991) (observing in a case involving the economic loss rule that “some contracts involve special relationships that may give rise to duties enforceable as torts, such as professional malpractice”).

<sup>32</sup> *See* *Derkevorkian v. Lionbridge Technologies, Inc.*, 2007 WL 638717, \*4 (D. Colo. 2007) (holding that the economic loss rule did not bar a “breach of fiduciary duty claim based on a confidential or trust relationship independent of the parties’ contractual relationship”); *Twin Fires Investment, LLC v. Morgan Stanley Dean Witter & Co.*, 2001 WL 1249303, \*4-\*5 (Mass. Super. Ct. 2001) (holding that a claim for breach of fiduciary duty was not barred by the economic loss rule). *But see* *Action Nissan, Inc. v. Hyundai Motor America*, 2008 WL 4093702 (M.D. Fla. 2008) (stating that “[w]hile the economic loss rule does not automatically bar a breach of fiduciary duty claim, the rule does apply when the claim for breach of fiduciary duty is based upon and inextricably intertwined with the claim for breach of contract,” and holding that the plaintiff’s claim was barred); *PNC Bank, National Ass’n v. Colonial Bank, N.A.*, 2008 WL 2917639, \*4 (M.D. Fla. 2008) (similar); *In re Trade Partners, Inc. Investors Litig.*, 2008 WL 3875396, \*17 (W.D. Mich.) (finding that because a trust agreement did not impose any duties beyond contractual duties, the plaintiff’s claims for negligence, gross negligence, and breach of fiduciary duty were barred by the economic loss doctrine).

<sup>33</sup> *See* *Holcomb Const. Co., Inc. v. Armstrong*, 590 F.2d 811, 812 (9th Cir. 1979) (holding that a cause of action for nuisance was stated based on negligent damage to a bridge which compelled the plaintiff to use a circuitous route

for the transportation of materials, which resulted in “greater cost”); *Burgess v. M/V Tamano*, 370 F. Supp. 247, 250 (D.C. Me. 1973) (allowing fishermen and clamdiggers to recover economic losses resulting from water pollution); *Leo v. General Elec. Co.*, 538 N.Y.S.2d 844, 847 (App. Div. 1989) (allowing fishermen to sue for “diminution or loss of livelihood” caused by water pollution). Where the action is for public nuisance, rather than private nuisance, the plaintiff’s action will fail unless the plaintiff established “special damages beyond those suffered by the public” in general. *See 532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Center, Inc.*, 727 N.Y.S.2d 49, 56 (N.Y. 2001) (denying recovery for economic harm to local businesses caused by a construction collapse). *See generally* *In re Exxon Valdez*, 104 F.3d 1196, 1197 (9th Cir. 1997) (refusing to award *noneconomic* damages based on harm to communal life resulting from a negligent oil spill, but noting that there was “no dispute concerning the Alaska Natives’ right to recover economic damage flowing from loss of fishing resources”).

<sup>34</sup> *See, e.g., Wolfgang v. Mid-American Motorsports, Inc.*, 914 F. Supp. 434, 438 (D. Kan. 1996) (stating that “Kansas recognizes that there are economic and noneconomic components to a loss of consortium claim”).

<sup>35</sup> *See, e.g., Gonzalez v. New York City Housing Authority*, 572 N.E.2d 598 (N.Y. 1991) (approving a substantial wrongful-death award to the independent, adult grandchildren of a brutally murdered woman from whom they had previously received meals, advice, and other forms of help).

<sup>36</sup> *See, e.g., Holmes v. Amerex Rent-A-Car*, 710 A.2d 846, 854 (D.C. 1998) (recognizing an action for economic damages caused by reckless or negligent spoliation of evidence). Some states have declined to endorse this cause of action. *See Trevio v. Ortega*, 969 S.W.2d 950, 959 (Tex. 1998) (opting for procedural sanctions for spoliation of evidence).

<sup>37</sup> For example, an Illinois statute imposes negligence-based obligations to protect data from unauthorized access and permits recovery of economic losses resulting from a breach. *See* 815 Ill. Comp. Stat. Ann. 505/10a(a) (West Supp. 2005).

<sup>38</sup> *See* Alaska Stat. § 46.03.822 (Westlaw 2008) (providing for strict liability for certain economic losses related to the release of hazardous substances). *See also Kodiak Island Borough v. Exxon Corp.*, 991 P.2d 757, 769 (Alaska 1999) (holding that in “allowing recovery for purely economic damages, Alaska’s hazardous substances statutes do not unduly interfere with the harmony or uniformity of federal maritime law”).



<sup>39</sup> See *America v. American Aviation, Inc.*, 891 So.2d 532, 543 n.3 (Fla. 2004) (principle recognized); *PNC Bank, National Ass'n v. Colonial Bank, N.A.*, 2008 WL 2917639, \*4 (M.D. Fla. 2008) (stating principle in dicta); *In re Ford Motor Co. E-350 Van Products Liability Litigation (No. II)*, 2008 WL 4126264, \*29 (D. N.J. 2008) (holding that the economic loss rule did not bar a claim under the New Jersey Consumer Fraud Act)). *But see* *Natarajan v. Paul Revere Life Ins. Co.*, 2008 WL 2885704, \*2 (M.D. Fla. 2008) (holding that RICO claims not based on acts independent of a breach of contract were barred by the economic loss rule); *Butcher v. DaimlerChrysler Co., LLC*, 2008 WL 2953472, \*4 (M.D. N.C. 2008) (holding that under North Carolina law, the economic loss rule bars a claim under the state deceptive trade practices act for economic losses).

<sup>40</sup> See *Union Oil Co. v. Oppen*, 501 F.2d 558, 565 (9th Cir. 1974) (discussing the “special relationship exception”). In *Union Oil*, the court wrote:

Prosser recognizes that a recovery for pure economic losses in negligence has been permitted in instances in which there exists “some special relation between the parties.” . . . . The failure of the plaintiff to obtain a contract because of a telegraph company’s negligent transmission of a message has been held to be legally cognizable, and is cited as an example of the ‘special relationship’ qualification. . . . Other examples which have been cited are the negligent failure to perform a gratuitous promise to obtain insurance, and the negligent delay in acting upon an application for insurance. . . .

501 F.2d 565.

<sup>41</sup> See *Robinson Helicopter Co., Inc. v. Dana Corp.*, 102 P.3d 268, 274 (Cal. 2004) (holding that the economic loss rule does not bar fraud and intentional misrepresentation claims); *EED Holdings v. Palmer Johnson Acquisition Corp.*, 387 F. Supp. 2d 265, 278 (S.D.N.Y. 2004) (stating that “New York courts have routinely permitted fraud and contract claims to proceed in tandem for the purpose of recovering pure economic loss” and holding that a fraud claim was not barred by the rule); *MyVitaNet.com v. Kowalski*, 2008 WL 2977889, \*9 (S.D. Ohio 2008) (holding that a fraud claim was not barred); *Granite Companies, LLC v. City Capital Corp.*, 2008 WL 3285914, \*3 (E.D. Pa. 2008) (holding that a fraud in the inducement claim was viable)..

In some jurisdictions, fraud in the inducement may be treated differently than fraud in the performance. See *D & M Jupiter, Inc. v. Friedopfer*, 853 So.2d 485, 487-88 (Fla. Dist. Ct. App. 2003) (stating “[w]hen the fraud relates to the performance of the contract, the economic loss doctrine will limit the parties to their contractual remedies. However,

when the fraud occurs in the connection with misrepresentations, statements, or omissions which cause the complaining party to enter into a transaction, then such fraud is fraud in the inducement and survives as an independent tort"). *See also* *In re Biddiscombe Intern., L.L.C.*, 2008 WL 3884329 (Bkrcty. M.D. Fla. 2008) (holding that the rule did not bar a claim for fraudulent inducement"); *Hotels of Key Largo, Inc. v. RHI Hotels, Inc.*, 694 So.2d 74, 78 (Fla. Dist. Ct. App. 1997) (stating that "[m]isrepresentations relating to the breaching party's performance of a contract do not give rise to an independent cause of action in tort, because such misrepresentations are interwoven and indistinct from the heart of the contractual agreement," in which case "the economic loss rule applies and the parties are limited to pursuing their rights in contract").

*See generally* R. Joseph Barton, Note, *Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims*, 41 Wm. & Mary L. Rev. 1789, 1789 (2000) (describing the economic loss rule as "one of the most confusing doctrines in tort law"); Christopher W. Arledge, *Is the California Supreme Court Confusing the Boundaries of the Economic Loss Rule?*, 47-May Orange County Law. 22, 24 (2005) (criticizing a decision holding that the economic loss rule did not bar a fraud claim that arose in the context of a contract for the sale of goods).

<sup>42</sup> *See Shands Teaching Hosp. and Clinics, Inc. v. Beech Street Corp.*, 899 So.2d 1222, 1228-29 (Fla. Dist. Ct. App. 2005) (holding that the rule did not bar a health care provider from suing the administrator of the State's group health insurance program for tortious interference with contract); Restatement (Second) of Torts §766 (1979) (providing that "[o]ne who intentionally and improperly interferes with the performance of a contract . . . between another and a third person by inducing or otherwise causing the third person not to perform the contract, is subject to liability to the other for the pecuniary loss resulting to the other from the failure of the third person to perform the contract").

<sup>43</sup> *See* Restatement (Second) of Torts §766B (1979) (providing that "[o]ne who intentionally and improperly interferes with another's prospective contractual relation (except a contract to marry) is subject to liability to the other for the pecuniary harm resulting from loss of the benefits of the relation, whether the interference consists of (a) inducing or otherwise causing a third person not to enter into or continue the prospective relation or (b) preventing the other from acquiring or continuing the prospective relation").

<sup>44</sup> *See Giles v. General Motors Acceptance Corp.*, 494 F.3d 865, 879-80 (9th Cir. 2007) (holding that

conversion and fraud claims were not barred); *Alex Hofrichter, P.A. v. Zuckerman & Venditti, P.A.*, 710 So.2d 127, 127 (Fla. Dist. Ct. App. 1998) (holding that the economic loss rule did not bar claims for conversion, civil theft, and constructive fraud where a lawyer converted partnership funds to personal use). *But see* *PNC Bank, National Ass'n v. Colonial Bank, N.A.*, 2008 WL 2917639, \*3 (M.D. Fla. 2008) (holding that a conversion claim was barred by the economic loss rule where it related “directly to the performance of the Agreement and is therefore ‘exactly coextensive’ with . . . [the plaintiff’s] breach of contract claim”).

<sup>45</sup> See Restatement (Second) of Torts §774A(1) (1979) (providing that “[o]ne who is liable to another for interference with a contract or prospective contractual relation is liable for damages for (a) the pecuniary loss of the benefits of the contract or the prospective relation; (b) consequential losses for which the interference is a legal cause; and (c) emotional distress or actual harm to reputation, if they are reasonably to be expected to result from the interference”).

<sup>46</sup> See Katarina P. Lewinbuk, *Let’s Sue All the Lawyers: The Rise of Claims Against Lawyers for Aiding and Abetting a Client’s Breach of Fiduciary Duty*, 40 Ariz. St. L.J. 135, 146 (2008) (noting that “[t]he critical distinction between a regular legal malpractice claim and a claim against an attorney for aiding and abetting her client’s breach of fiduciary duty is that ‘there need be no allegation that the attorney actually owed the plaintiff a direct duty of care’”); Douglas R. Richmond, *Lawyer Liability for Aiding and Abetting Clients’ Misconduct Under State Law*, 75 Defense Couns. J. 130, 130 (2008) (indicating that “the theory gained serious traction during the savings and loan crisis of the mid- to late 1980’s and early 1990’s, when government regulators and private plaintiffs sued numerous law and accounting firms for their alleged roles in institutional failures principally attributable to corrupt directors and officers” ).

<sup>47</sup> London, *supra* note 47, at Daniel London, *Is the Economic Loss Rule in Peril? Courts, Negligence and the Economic Loss Wolves*, 71 Def. Couns. J. 379, 380 (2004).

<sup>48</sup> See Feinman, *supra* note 1, at 813 (opining that “there is not one economic loss rule, but several”); Gruning, *supra* note 1, at 208 (stating that “American tort law displays many economic loss rules not merely because many states contribute to their elaboration. It also displays many such rules because the problem of economic loss itself is plural and variegated”); Dobbs, *supra* note 1, at 714 (discussing two “distinct” rules).

<sup>49</sup> In fact, courts differ in how they articulate the limits on the liability of accounts to third parties. *See* Vincent R. Johnson & Shawn M. Lovorn, *Misrepresentation by Lawyers About Credentials or Experience*, 57 Okla. L. Rev. 529, 566 (2004) (indicating that the accounting liability cases tend to follow one of three views, which require either privity or near-privity between the parties, foreseeability of reliance, or reliance by “one of a limited group of persons for whose benefit the information was supplied”).

<sup>50</sup> *See* Castle v. Williams, 788 N.E.2d 421, 424 (Ill. Ct. App. 2003) (finding that “a person who tortiously causes physical harm to an agent is not liable to the principal for the harm thereby caused to him”). *See also* Lauria v. Mandalay Corp., 2008 WL 3887608, \*2 (D. N.J. 2008) (holding the context of a slip and fall accident that “neither New Jersey nor Nevada law would permit an employer to recover under a negligence theory for economic losses solely derived from an injury to an employee”).

<sup>51</sup> *See* Part II-C.

<sup>52</sup> *See* note 171 and the accompanying text.

<sup>53</sup> *See* Rabin, *supra* note 1, at 859 (opining that “the constraints imposed by the economic loss rule do not . . . reflect any single normative principle” and “the cases do not comprise a single generic category guided by a unified set of underlying policy considerations”).

<sup>54</sup> *See, e.g.,* Gray, *supra* note 1, at 899; Rabin, *supra* note 1, at 859 (suggesting that “attempts to generate a single rationale for what the courts are doing run the risk of oversimplifying the policy concerns at stake”).

<sup>55</sup> According to the American Law Institute:

The Council approved the start of the project in 2004. Thus far, no part of the work has been approved by the Council or by the membership. Professor Mark Gergen resigned as the project's Reporter in late 2007; the project is in abeyance while the Director seeks a successor Reporter.

[http://www.ali.org/index.cfm?fuseaction=projects.proj\\_ip&projectid=15](http://www.ali.org/index.cfm?fuseaction=projects.proj_ip&projectid=15) (last visited Sept. 6, 2008).

<sup>56</sup> Two drafts were submitted to the Members Consultative Group addressing the economic loss rule. *See* Restatement (Third) of Torts: Liab. for Econ. Loss §8 (Preliminary Draft No. 1, 2005); Restatement (Third) of Torts: Econ. Torts & Related Wrongs §8 (Preliminary Draft No. 2, 2006). Focusing on third-party cases, one leading scholar

described the position of Preliminary Draft No. 1 as “extreme” and Draft No. 2 as “less restrictive” and “narrower.” Feinman, *supra* note 1, at 820. Two drafts were submitted to the Council of the Institute. *See* Restatement (Third) of Torts: Econ. Torts & Related Wrongs §8 (Council Draft No. 1, Oct. 2, 2006); Restatement (Third) of Torts: Econ. Torts & Related Wrongs §8 (Council Draft No. 2, Oct. 5, 2007).

<sup>57</sup> *See* [http://www.ali.org/index.cfm?fuseaction=projects.proj\\_ip&projectid=15](http://www.ali.org/index.cfm?fuseaction=projects.proj_ip&projectid=15) (last visited Sept. 6, 2008) (stating that “[t]hus far, no part of the work has been approved by the Council or by the membership”).

<sup>58</sup> *See* *Indemnity Ins. Co. of North America v. American Aviation, Inc.*, 891 So.2d 532, 536 (Fla. 2004) (asserting that “there has been much confusion about the scope of this doctrine”); Barton, *supra* note 41, at 1789 (describing the economic loss rule as “one of the most confusing doctrines in tort law”).

<sup>59</sup> *See* Bernstein, *supra* note 6, at 112 (opining that American law is “generally opposed” to recovery for pure economic loss on a negligence theory”); Gruning, *supra* note 1, at 187 (stating that “even clearly demonstrable economic losses that cannot be characterized as dependent on physical harm to the plaintiff are generally not compensated”).

<sup>60</sup> *See, e.g.,* Emily Kuwahara, *Torts v. Contracts: Can Microsoft Be Held Liable to Home Consumers for Its Security Flaws*, 80 So. Cal. L. Rev. 997, 1025-31 (2007) (suggesting that the economic loss rule would bar tort claims related to three forms of software-related cyber attacks: deletion of files, misappropriation of data, and denial of service).

<sup>61</sup> *See* Pryor, *supra* note 1, at 905 (noting that “[o]ver the past 25 years, the ‘economic loss rule’ has created a sprawling caselaw, which has elevated it from its once-provincial role in products liability to a dominant argument in all manner of economic harm cases”). *See also* Feinman, *supra* note 1, at 815-17 (discussing the historical background of liability for third-party economic loss and stating that “[u]ntil the 1950s, limiting doctrines such as privity and restrictive liability rules in misrepresentation and negligence made it virtually impossible for a third party to recover for negligently-inflicted economic loss”).

The historical origins of the economic loss rule depend on branch of the rule with which one is concerned. The branch of the rule denying compensation for negligently caused interference with contract has been traced to *Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303 (1927) (Holmes, J.). *See* Gruning, *supra* note 1, at 189-90 (discussing

*Robbins*). The *Robbins* line of development is reflected in Restatement (Second) of Torts §766C (1979) (providing that “[o]ne is not liable to another for pecuniary harm not deriving from physical harm to the other, if that harm results from the actor’s negligently (a) causing a third person not to perform a contract with the other, or (b) interfering with the other’s performance of his contract or making the performance more expensive or burdensome, or (c) interfering with the other’s acquiring a contractual relation with a third person”).

The branch of the rule denying compensation under tort law for harm caused by defective products originated with *Seely v. White Motor Co.* 403 P.2d 145 (Cal. 1965) (Traynor, J). See *Congregation of the Passion, Holy Cross Province v. Touche Ross & Co.*, 636 N.E.2d 503, 512 (Ill. 1994) (discussing *Seeley*); *Town of Alma v. Azco Const., Inc.*, 10 P.3d 1256, 1259-61 (Colo. 2000) (discussing the origins of the economic loss rule and explaining it a limited principle which preserved a proper sphere for contract law after the adoption of strict products liability).

A pivotal event in the recent development of the economic loss rule was Justice Harry Blackmun’s opinion in *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 876 (1986) (holding that “whether stated in negligence or strict liability, no products-liability claim lies in admiralty when the only injury claimed is economic loss”). That decision, together with the previously established rule that negligent interference with contract or prospective advantage is not actionable, catalyzed efforts to articulate a grander formulation of an economic loss rule that applies beyond the fields of products liability or tortious interference. “The ‘economic loss doctrine’ as a separately named and articulated doctrine dates only from the last half century.” *Giles v. General Motors Acceptance Corp.*, 494 F.3d 865, 873 (9th Cir. 2007).

<sup>62</sup> See, e.g., Dan B. Dobbs & Ellen M. Bublick, *Advanced Torts: Economic and Dignitary Torts* 431-53 (2006) (discussing “products and the Economic Loss Rule(s)”; Jerry J. Phillips, et al., *Tort Law: Cases, Materials, Problems* 518-28 (3d ed 2002) (discussing economic loss as a result of negligence); David W. Robertson, et al., *Cases and Materials on Torts* 253-71 (3d ed. 2004) (discussing economic loss without physical injury); Aaron D. Twerski & James A. Henderson, *Torts: Cases and Materials* 318-36 (2003) (discussing limitations on recovery for pure economic loss).

<sup>63</sup> See, e.g., *In re Adelphia Communications Corp.*, 2008 WL 3919198, \*4 n.3 (S.D.N.Y. 2008) (finding it unnecessary to address the appellee’s arguments that certain tort claims were barred by the “economic loss rule,” because the appellants conceded they were not seeking tort damages); *Mason v. Chase Bank of Texas, N.A.*, 2008 WL

3412212, \*2 (Tex. App.-Dallas 2008) (noting the defendant's assertion that the rule was grounds for summary judgment in a suit relating to a construction loan); *King v. Rice*, 2008 WL 4118211, \*3 (Wash. Ct. App.) (holding that the economic loss rule did not bar negligence and malicious mischief claims related to destruction of a modular living unit).

<sup>64</sup> See, e.g., *Bryan's Quality Plus, LLC v. Shaffer Builders, Inc.*, 2008 WL 3523935, \*5, n.10 (E.D. Pa. 2008) (holding that claims relating to a construction dispute were barred by the economic loss rule).

<sup>65</sup> *Grams v. Milk Products, Inc.*, 699 N.W.2d 167, 180 (Wis. 2005) (Abrahamson, C.J., dissenting) (citing a study of cases from 2000 to 2004).

<sup>66</sup> *Grams v. Milk Products, Inc.*, 699 N.W.2d 167, 181 (Wis. 2005) (Abrahamson, C.J., dissenting).

<sup>67</sup> “[W]here stops the reason, there stops the rule.” *Vargo v. Schwartz*, 2007 WL 1589502, \*12 n.7 (Pa. Com. Pl. 2007). “When the reason of the law ceases, the law itself also ceases.” *Black's Law Dictionary App. B* (8th ed. 2004) (translating the maxim).

<sup>68</sup> Cf. Bernstein, *supra* note 1, at 774 (stating that “pure economic loss ‘remains a backwater within the discourse of American tort law’”), quoting Gary T. Schwartz, *American Tort Law and the (Supposed) Economic Loss Rule*, in *Pure Economic Loss in Europe* 94, 96 (Mauro Bussani & Vernon Palmer eds., 2003).

<sup>69</sup> See Part I-A.

<sup>70</sup> See Part II-C-2.

<sup>71</sup> See Part III-A.

<sup>72</sup> See Part III-B.

<sup>73</sup> See Part III-C-3.

<sup>74</sup> See Part III-C-5.

<sup>75</sup> See Part III-C-4.

<sup>76</sup> See generally Gruning, *supra* note 1, at 206-208 (discussing the economic loss rule and policy); Vincent R. Johnson, *Standardized Tests, Erroneous Scores, and Tort Liability*, 38 Rutgers L.J. 655, 680-84 (2007) (discussing the economic loss rule in the context of standardized-test mis-scoring litigation).

Three purported justifications for the economic loss rule that are not discussed in the text concern simplicity, similarity, and social loss. Some writers argue that the economic loss rule reflects a preference for keeping the cases that fall within the purview of tort law simple. See Bernstein, *supra* note 1, at 777 (stating that “[t]ort law refuses to recognize actions for pure consequential financial loss because these claims are not easy enough to follow. . . . To remain intelligible to prospective plaintiffs, tortfeasor-defendants, and (in the United States) jurors, tort law must articulate its demands simply, with a relatively low common denominator in mind”). Other writers argue that pure economic loss is not actionable because, unlike personal injury or property damage, it is too similar to the types of losses that capitalism takes for granted. See generally Restatement (Third) of Torts: Liab. for Econ. Loss §8 cmt. b (Preliminary Draft No. 1, 2005) (stating that “[s]ome believe solely pecuniary harm merits less legal protection than harm to person or property because pecuniary losses often are not social losses. One firm’s lost profit is likely to be another firm’s profit gained”). The social-loss rationale is a theory that seems to have little impact on the adjudication of real cases. Courts rarely mention this idea in their opinions.

<sup>77</sup> Gray, *supra* note 1, at 898. Addressing the foundational uncertainty surrounding the various limitations on tort liability for economic loss, Professor Gray wrote:

Perhaps there is here a flavor of a “standing” issue—a difference sensed between a complaint about harm to one’s own property as compared with harm to another’s. Perhaps, similarly, there is a concern with the possibility of duplicative claims, if these boundary lines are crossed. Fear of “indeterminate” or “incalculable” damages is sometimes expressed, for reasons not specified—perhaps concern about actuarial unmanageability, that is, non-insurability, except at exorbitant premiums, or subject to unwelcome restrictions, such as deductibility requirements.

. . . .

These concerns are often coupled with references to the expected “ripple-effects” in the economic impacts from negligence, where the expected physical effects would be more limited.

[Another reason is that] . . . [a] paradoxical situation can arise where there is a very large number of potential victims (as in conflagration cases, in the realm of physical damages) and better risk distribution may be obtained by leaving losses to lie where they fall than by attempting to concentrate them on an injurer—even if the injurer is to some extent insured.

*Id.* at 898-99.



The highwater mark in opaque jurisprudence relating to liability for economic loss may have been the famous case of *Petitions of Kinsman Transit Co.* (*Kinsman No. 2*), 388 F.2d 821, 824-25 (2d Cir. 1968). The plaintiffs were the owners of wheat stored aboard a ship which could not navigate the river because of the wreckage of a collapsed bridge. They brought suit to recover the costs of being forced to transport the wheat via an alternative route. The court held that even though it was foreseeable that commerce on the river would be disrupted and that some parties would incur such costs, the relationship of those costs to the defendants' negligence was "too tenuous and remote" to permit recovery. Prosser said that just what this phrase means "would appear to be anybody's guess." *See* W. Page Keeton et al, *Prosser and Keeton on Torts* 297 (5th ed. 1984). *Kinsman No. 2* contains a famous footnote. Writing for the court, Judge Irving Kaufman stated in dicta:

To anyone familiar with N.Y. traffic there can be no doubt that a foreseeable result of an accident in the Brooklyn Battery Tunnel during rush hour is that thousands of people will be delayed. A driver who negligently caused such an accident would certainly be held accountable to those physically injured in the crash. But we doubt that damages would be recoverable against the negligent driver in favor of truckers or contract carriers who suffered provable losses because of the delay or to the wage earner who was forced to 'clock in' an hour late.

*Id.* at 825 n.8.

<sup>78</sup> *See Aikens v. Baltimore and Ohio R. Co.*, 501 A.2d 277, 279 (Pa. Super. Ct 1985) (stating, in rejecting a claim for lost wages brought by the employees of a plant damaged by a train derailment, that "[t]o allow a cause of action for negligent causation of purely economic loss would be to open the door to every person in the economic chain of the negligent person or business to bring a cause of action. Such an outstanding burden is clearly inappropriate and a danger to our economic system"). *See also* David B. Gaebler, *Negligence, Economic Loss, and the U.C.C.*, 61 Ind. L.J. 593, 611-12 (1986) (stating that "Professor [Fleming] James noted that as a practical matter the physical consequences of negligence are usually limited, but that "the indirect economic repercussions of negligence may be far wider, indeed virtually open-ended"); Pryor, *supra* note 1, at 907 (noting that "[t]he economic loss rule rests in part on considerations that also have insurance implications, such as unpredictability about the extent and scope of purely economic ripple effects"); Johnson, *supra* note 28, at 296-97 (asserting that "somewhat crudely, the economic-loss rule protects potential defendants from the risk of a disproportionately wide range of liability") (citing Jay M. Feinman,

Economic Negligence: Liability of Professionals and Businesses to Third Parties for Economic Loss §§ 1.2 & 1.3.2 (1995)). *See generally* Banknorth, N.A. v. BJ's Wholesale Club, Inc., 442 F. Supp.2d 206, 213-14 (M.D. Pa. 2006) (rejecting the plaintiff's arguments related to unlimited liability concerns "because there are many rationales for the economic loss rule").

Professor Herbert Bernstein suggests that defenders of the economic loss rule erroneously assume that "widespread liability is a serious concern only in nonphysical harm cases, and that widespread liability is generally of no concern when negligence has caused personal injury or physical damage to property." Bernstein, *supra* note 6, at 127. Under their view, "more than 150 years of rapid industrialization with the attendant phenomenon of mass torts involving physical injuries of sometimes staggering proportions go virtually unnoticed." *Id.* at 127

<sup>79</sup> *See* Johnson, *supra* note 28, at 297-98 (stating that "lost economic opportunities are often not readily susceptible to precise calculation . . . [and that by] ruling out litigation in a huge range of cases (suits involving no personal injury or property damage), the economic-loss rule helps to ensure (. . . somewhat crudely) that compensation is not awarded for amounts that are speculative").

<sup>80</sup> *See* Aikens v. Baltimore and Ohio R. Co., 501 A.2d 277, 279 (Pa. Super. Ct 1985) (stating that "allowance of a cause of action for negligent interference with economic advantage would create an undue burden upon industrial freedom of action, and would create a disproportion between the large amount of damages that might be recovered and the extent of the defendant's fault") (citing Restatement (Second) of Torts § 766C, comment a (1979)). *See also* Kevin J. Breer & Justin D. Pulikkan, *The Economic Loss Rule in Kansas and Its Impact on Construction Cases*, 74-Jun J. Kan. B.A. 30, 31 (2005) (asserting that "[t]he primary motivation behind the economic loss rule is the fear that allowing a party to proceed in tort would result in 'crushing useful activity by a liability'"); London, *supra* note 47, at 381 (discussing the risk that liability for economic loss will result in over- deterrence); Rabin, *supra* note 1, at 862 (stating that "it is critical to note that the concern over ripple effects is not synonymous with a crushing liability concern").

<sup>81</sup> *See* Gaebler, *supra* note 78, at 612.

<sup>82</sup> *See, e.g.,* Health Call of Detroit v. Atrium Home & Health Care Services, Inc., 706 N.W.2d 843, 852 (Mich. App. 2005) (stating that "[t]he general rule is that remote, contingent, and speculative damages cannot be recovered in Michigan in a tort action").

<sup>83</sup> See, e.g., *Johansen v. Combustion Engineering, Inc.*, 170 F.3d 1320, 1328 (11th Cir. 1999) (stating that “when a court finds that a jury’s award of damages is excessive, it may grant the defendant a new trial”).

<sup>84</sup> See W. Page Keeton et al, *Prosser and Keeton on Torts* 280-81(5th ed. 1984) (discussing unforeseeable consequences).

<sup>85</sup> Cf. *Restatement (Third) of Torts: Liability for Physical Harm* § 29 (P.F.D. No. 1 2005) (providing that “[a]n actor’s liability is limited to those physical harms that result from the risks that made the actor’s conduct tortious”).

<sup>86</sup> Gaebler, *supra* note 78, at 612.

<sup>87</sup> See *Castle v. Williams*, 788 N.E.2d 421, 424 (Ill. Ct. App. 2003) (denying recovery of negligently caused economic losses resulting from injury of a key employee in an auto accident because “employers are in the better position to insure against such a loss through the purchase of ‘key man’ insurance and business management”).

<sup>88</sup> See generally Guido Calabresi, *The Costs of Accidents* 45, 55-64 (1970) (discussing the reasons that private insurance gives rise to inadequate loss spreading); Johnson, *supra* note 76, at 669 n.91 (discussing spreading as it related to products liability and *respondeat superior*); Johnson, *supra* note 28, at 276 (asserting that, in addressing unsettled questions of duty, “[c]ourts sometimes . . . consider ‘the availability, cost, and prevalence of insurance for the risk involved,’ with the assumption being that insurability of the risk makes imposition of a duty more palatable because of the cost-spreading ability of insurance”).

<sup>89</sup> Cf. Pryor, *supra* note 1, at 918 (stating that “one is hard-pressed to argue that pure economic loss is uninsurable. Perhaps the strongest insurability concern would be moral hazard. If the loss is the failure to live up to the contract’s performance obligations, resulting in a diminished value or quality of service, then the presence of insurance could reduce the insured’s incentives to live up to the contract”). But see London, *supra* note 47, at 383 (discussing the types of insurance available for economic loss and arguing that third-party insurance may be undesirable).

<sup>90</sup> Cf. Vincent R. Johnson & Claire G. Hargrove, *The Tort Duty of Parents to Protect Minor Children*, 51 Vill. L. Rev. 311, 329 (2006) (opining that “[w]hether a device for spreading losses (such as insurance) is available is only significant if the loss is of the kind that should be spread. Losses caused by highly blameworthy conduct are not of that variety”).

<sup>91</sup> See *Edward F. Heimbrock Co., Inc. v. Marine Sales and Service, Inc.*, 766 S.W.2d 70, 72 (Ky. Ct. App. 1989) (denying recovery to an employer for economic losses stemming from injuries to an employee because “employers who are in a better position to insure against loss”); *Ferguson v. Green Island Contracting Corp.*, 355 N.Y.S.2d 196, 198 (App. Div. 1974) (similar).

<sup>92</sup> But see *Daanen & Janssen, Inc. v. Cedarapids, Inc.*, 573 N.W.2d 842, 846 (Wis.1998) (asserting that the “[a]pplication of the economic loss doctrine to tort actions between commercial parties is . . . [intended] to encourage the party best situated to assess the risk economic loss, the commercial purchaser, to assume, allocate, or insure against that risk”).

<sup>93</sup> *Johnson & Gunn*, *supra* note 23, at 9.

<sup>94</sup> See *Union Oil Co. v. Oppen*, 501 F.2d 558, 570 (9th Cir. 1974) (extensively discussing the economic theories of Guido Calabresi).

<sup>95</sup> *London*, *supra* note 47, at 381-82 (quoting Lord Denning in *Spartan Steel & Alloys Ltd. v. Martin & Co.*, [1973] 1 Q.B. 27, 38).

<sup>96</sup> See *London*, *supra* note 47, at 382 (stating “[t]he line between ‘healthy attitude’ that bears the cost of economic loss and economic loss worthy of compensation is unclear. The economic loss rule takes the line-drawing function away from the trier of fact and denies any recovery for economic loss”).

<sup>97</sup> See *Level 3 Communications, LLC v. Liebert Corp.*, 2008 WL 2908933, \*14 (10th Cir. 2008) (indicating that “[b]roadly speaking, the economic loss rule is intended to maintain the boundary between contract law and tort law”), *citing* *Town of Alma v. AZCO Constr., Inc.*, 10 P.3d 1256, 1259 (Colo.2000); *Colleton Preparatory Academy, Inc. v. Hoover Universal, Inc.*, 2007 WL 5433193, \*3 (S.C. 2008) (stating that “[t]he purpose of the economic loss rule is to define the line between tort and contract recovery”); *Grams v. Milk Products, Inc.*, 699 N.W.2d 167, 169 (Wis. 2005) (stating that “[t]he economic loss doctrine is a judicial doctrine intended to preserve the fundamental distinction between contract and tort”).

<sup>98</sup> *Edelstein*, *supra* note 21, at 43.

<sup>99</sup> See *Gruning*, *supra* note 1, at 191-206 (discussing nine fact situations, generally not involving an agreement

between the plaintiff and defendant, where compensation is often, but not always, denied for purely economic loss).